SMALL BUSINESS ADMINISTRATION'S 8(a) PROGRAM

HEARINGS

BEFORE THE

SUBCOMMITTEE ON SBA AND SBIC AUTHORITY, MINORITY ENTERPRISE AND GENERAL SMALL BUSINESS PROBLEMS

OF THE

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HOUSE OF REPRESENTATIVES

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SMALL BUSINESS ADMINISTRATION'S 8(a) PROGRAM

THURSDAY, MAY 21, 1981

House of Representatives, Subcommittee on SBA and SBIC Authority, Minority Enterprise, and General Small Business Problems, Committee on Small Business,

Washington, D.C.

The subcommittee met, pursuant to notice, at 8:30 a.m., in room 2359-A, Rayburn House Office Building, Hon. Parren J. Mitchell (chairman of the subcommittee) presiding.

OPENING STATEMENT OF CHAIRMAN MITCHELL

Mr. Mitchell. The hearing will come to order.

Good morning. Today's hearing is one of many hearings I will conduct to examine how the new Reagan administration, particularly the Small Business Administration, is implementing the laws passed by Congress to assist small, socially and economically disadvantaged business. When I assumed the chairmanship of the Small Business Committee in January of this year, I announced my intent to monitor vigorously agencies' compliance with existing small business laws. I am of the belief that it is of little utility for Congress to have passed laws and to have such laws rarely implemented by the agencies which are mandated to carry out the wishes of Congress.

Today's hearing will focus on the Small Business Administration's implementation and management of the 8(a) program; a program designed by Congress to assist socially and economically disadvantaged businesses. The ultimate objective of this program is to aid in the development and growth of minority businesses so that they can more equitably participate as true partners in this Nation's free enterprise system.

For far too many years, the Federal Government was an active participant in practices which virtually excluded minority businesses from participating in a multibillion dollar procurement system. Within the last 12 years, the role of the Federal Government has undergone increasing modification to reflect a more positive attitude toward the minority business community. This change has resulted in some gains being achieved by minority businesses. By and large, however, minority businesses have not reached a level of development in which they can openly compete with their majority counterparts.

To understand better the continuing struggle of minority businesses to achieve economic parity, viability, and maturity in a system which has a long history of institutional practices designed to thwart progress, it is necessary to provide a short review of the changing role the Federal Government has played in pursuit of the goal of equality for minority business.

The Kerner report of the late 1960's in the wake of one of the Nation's most civilly eruptive and disruptive periods, spoke to the concept of ownership. In this instance, however, minority ownership was the subject. In spite of the development of job opportunities; creation of immense social welfare programs; legislative reaffirmations of constitutional rights * * * it was found that the minority pursuit of ownership was as intrinsic to their philosophy as it was for their majority counterparts. It became equally as evident that the Federal Government had done little, nor had plans to do more in the future, with regard to minority business enterprise development.

As a result of this condition, some immediate steps were taken by the Government to, at least, mitigate the problem. That is: One, section 8(a) of the Small Business Act was identified as a legislative vehicle by which minorities would have more equal access to Federal Government procurement and contracting opportunities, thus the evolution of the 8(a) program; two, the Small Business Administration was formally alerted to the unique problems of minority businesses and authorized to establish minority business enterprise programs, goals, and objectives, and make available to minority businesses all programs and services offered to small business enterprises in general; three, the Office of Minority Business Enterprise was created within the Department of Commerce by executive order to work exclusively for minority business concerns and in coordination with those agencies of the Federal Government impacting upon minority business enterprise; four, the position of Associate Administrator for Minority Small Business was created within the Small Business Administration; five, subpart 1-1.13: Minority Business Enterprise, of title 41: Public Contracts and Property Management—was attached to that amendment of the Federal procurement regulations "to foster and encourage the participation of minority business enterprise in the subcontracts awarded by Government prime contractors."

The period from 1969 to 1977 gave rise to much concern about the minority business enterprise issue and the far broader issue of minority economic development. The question of minority economic parity was addressed through voluminous research and statistical documentation, numerous formal Government agency and private sector discussions, and formal testimony before committees of the Congress. What became quite evident was the need for specific and immediate legislative action with regard to minority business initiative. In addition, there was a critical need for the efficacious implementation and ongoing analyses of Federal Government programing in the effort to insure minority business enterprise growth and development, while moving closer to the ultimate goal of minority economic parity.

To truly grasp the full meaning of minority economic parity and yet understand the ramifications of the issue requires one to wade through an ocean of statistics and overcome the tidal waves of its complexities. It is a fact that minority business enterprise has experienced some growth; however, such growth is only as relevant as its parallel relationship to national economic growth. The statistical data from a 1969 report issued by the Department of Commerce on minority-owned businesses indicated that there were approximately 322,000 minority-owned businesses, comprising 4.3 percent of the 7.5 million businesss in America. In addition, the report stated that the total minority business receipts constituted $10.6 billion or 0.7 percent of the total 1967 receipts of $1.498 trillion reported by all business. "The 1972 Survey of Minority-owned Business Enterprise—Black" (MB72-1), a special report issued by the Department of Commerce's Social and Economic Statistics Administration, and the first in a series of special reports on minority-owned businesses, indicated that there were approximately 195,000 black businesses in the Nation generating $7.1 billion in gross receipts. The average receipts per black firm was $13,000 per annum. In comparison, varying population statistics indicated that minorities comprise between 17 percent and 20 percent of the total U.S. population—those statistics are highly speculative, for blacks alone may comprise more than 15 percent of the total population. Consequently, if one were to address the mathematics of the situation, one could ascertain that the ratio of business dollars generated by minorities as equated with the minority percentage of the Nation's population is alarmingly disproportionate. In this regard, the verity of minority business enterprise growth belies the reality of an inadequate growth pattern and the road to minority economic parity continues to become longer and more circuitous. If we are of the opinion that minority economic parity will come as a result of normal economic evolutionary trends, we need to quickly check our premise. For the longer we procrastinate in starting the machinery to solve the problem, the more fuel will be required. In this vein, I am speaking of dollars and ways to begin to solve a problem which will expend millions of dollars rather than wait until a later time when it will cost us billions.

In response to these conditions, in 1978 Public Law 95-507 was enacted. This law is designed to assist and to foster the development of socially and economically disadvantaged businesses. It recognizes that these businesses are not presently capable of competing with their majority counterparts and therefore procurement opportunities, management, and technical assistance must be provided if the free enterprise system is to work.

Public Law 95-507 consists of several major components including the 8(a) program. Agencies are required by law to provide SBA with procurement contracts for socially and economically disadvantaged businesses. In turn, SBA subcontracts these procurements to certified firms.

In 1977, socially and economically disadvantaged businesses received less than 1 percent of the total Federal Government budget of nearly $100 billion. Through the 8(a) program and a very aggressive compliance review, in 1980 socially and economically disadvantaged businesses received nearly 3 percent of the total Federal procurement budget. Surely this does not approach economic parity, but it is a step in the right direction. These gains will be dissipated if the 8(a) program as well as other minority business programs are not strengthened.

On May 1, 1981, Mr. Cardenas, Administrator of the Small Business Administration, announced "new tough policies for the 8(a) program." I am concerned that many of these policies were announced without consultation with this committee. I am concerned that the SBA action may undermine the intent of Congress in mandating 8(a) activity. I am also concerned that some appear to violate statutory or regulatory guidelines. Of far more importance, however, many of these policies have created havoc and confusion in the minority business community and in the Federal procurement arm of this Government.

The purpose of today's hearing is to solicit clarification from the administration regarding the May 1, 1981, policy statements and the manner in which SBA is moving to implement and comply with Public Law 95-507 and Public Law 96-481.

Today, Mr. Cardenas, Administrator of the Small Business Administration, will present testimony regarding the concerns previously outlined.

I am delighted that Mr. Ireland and Mr. Evans are present with us. Do either of you gentlemen have an opening statement?

Mr. **Ireland**. No, sir.

Mr. **Evans**. No, sir.

Mr. **Mitchell**. I understand some members of the minority side will be joining us.

Did Mr. McDade submit an opening statement?

Mr. **Blackistone**. Yes, he did; and we ask unanimous consent that it be entered into the record.

OPENING STATEMENT OF HON. JOSEPH. M. McDADE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF PENNSYLVANIA

Mr. **McDade**. Mr. Chairman, your scheduling these hearings on SBA's 8(a) program is very constructive. I support the goal of providing opportunity to minority and disadvantaged businesses. However, while the 8(a) program appears to be an effective mechanism for helping disadvantaged small businesses become successful, it has not worked well.

Recent evaluations by the General Accounting Office, the SBA Inspector General, and others have been very critical of the way in which the 8(a) program operates. There have been, in fact, widespread allegations of abuses. Last month's GAO report on 8(a) noted that of the nearly 4,600 firms which have participated in the program, only 116 have graduated as competitive businesses. More than 30 percent of the total 8(a) contracts have gone to 50 firms which still continue to participate in 8(a). GAO questioned whether many of the firms it examined should continue in the program. Because there firms have not been graduated, other disadvantaged businesses have not been able to take advantage of the program.

Clearly, aggressive action is needed to clean up this program and restore the credibility which is now lacking. I am pleased that SBA now appears interested in correcting the problems which currently exist. This hearing, and the ones to follow, will allow us to review the effectiveness of the proposed changes in the program and to assure that those small firms which truly need assistance will be able to get it.

GAO concluded that "the reasons why the program is ineffective have been long known to Congress, SBA, and to other outside organizations. Despite the criticism, adequate corrective action has not been taken and the problems continue." I hope we will see adequate corrective action taken on the 8(a) program soon.

Mr. MITCHELL. The Chair would also ask unanimous consent to insert the opening statement of Mr. Addabbo into the record.

OPENING STATEMENT OF HON. JOSEPH. P. ADDABBO, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK

Mr. ADDABBO. Mr. Chairman, you could not have called these hearings at a more opportune moment. Unfortunately, we are faced once more with a threat to the continuation of the only program in the Government providing unique business oppportunities to socially and economically disadvantaged business.

Over the past year or two, there has been significant improvement in the share of Federal procurement going to disadvantaged firms. We have finally reached many of the procurement people who initially resisted the 8(a) program. As the saying goes, they tried it, and they liked it. Now that this has been accomplished, we have another threat. In October of last year, the Congress responded to problems raised with the 8(a) program by passing Public Law 96-481. The Small Business Administration was mandated with the implementation of this law, and was supposed to have come forth with regulations more than 3 months ago. As we all know, nothing has been forthcoming, not even a proposed rulemaking. Instead, SBA takes it upon itself to spend its time working on "tough new policies".

Any effort to improve on the 8(a) program is to be commended. However, SBA's recent actions may well have done more harm than good in light of the reports I have been getting from other agencies. They are in the dark as to what SBA plans to do about the June 1 deadline, and have been given assurances that SBA's new policies will not impede the very real procurement needs of those agencies. I hope this hearing will focus on this.

My other concern is with the disadvantaged firms, who have seen program delivery come to a virtual halt while SBA decides what is best for them, and hopefully for the Nation. I hope that with all of these new policies, SBA takes the time to try to improve on the services that it is charged with providing to disadvantaged firms.

Thank you, Mr. Chairman.

Mr. MITCHELL. Mr. Cardenas, we thank you for being here. We know you have testified frequently on the Hill. We will now hear from you.

TESTIMONY OF HON. MICHAEL CARDENAS, ADMINISTRATOR, SMALL BUSINESS ADMINISTRATION, ACCOMPANIED BY DONALD TEMPLEMAN, DEPUTY ADMINISTRATOR, AND ROBERT L. WRIGHT, ASSOCIATE ADMINISTRATOR, MINORITY SMALL BUSINESS AND CAPITAL OWNERSHIP AND DEVELOPMENT

Mr. CARDENAS. Thank you, Mr. Chairman. My appreciation to you for the invitation, and certainly the other members of the committee and the staff, to discuss important issues relating to SBA's small business programs, the 8(a) program for small, socially and economically disadvantaged entrepreneurs, and SBA's management of the programs.

Before being appointed as Administrator of the Small Business Administration, I knew that the 8(a) program was one of the most controversial, misunderstood, and maligned programs of SBA. Yet I strongly believe, as does the Reagan administration, that SBA has an important mission and responsibility to provide assistance and opportunity to those small, socially and economically, disadvantaged entrepreneurs who wish to become business persons.

Before I could set the course for a better program delivery system it was necessary to study the current and past problems, the criticisms of the public, the Congress, and the many investigations by GAO and the SBA Inspector General. I found that for several years the same problems have continued to reappear with minimal remedial action having been taken. I also found that the 8(a) program had undergone since inception development by administrative decision ranging from a test cities program, a job employment program, to a program for entrepreneurs. It was not until October 24, 1978, 10 years after the program's inception, that the Congress defined in Public Law 95-507 the sincere concern that assistance to minority small businesses was an essential necessity for the free enterprise system and better economic development of these United States. The passage of Public Law 96-481 further enhanced and defined the program direction in support of small minority business. Both laws were helpful to a better understanding of program direction and compatible with the administration's viewpoint concerning the assistance required by the small minority business community.

As Administrator of SBA, my role is to insure that rules and regulations, program operating procedures, and program direction are adequate to implement the law. When I arrived at SBA I found that existing direction, rules and regulations, and operating procedures did not fully reflect the intent of the Small Business Act. I also found the work on the new regulations required by Public Law 96-481 was not progressing in accordance with the schedule specified in the law.

I believe that no mission or program can attain optimum success or cost effectiveness without strong management direction. It is my intent to address those areas where problems continue to exist and to expand program participation opportunity to the greatest number of small, socially and economically, disadvantaged businesses.

In order to provide proper 8(a) program opportunity to thousands of deserving eligible small disadvantaged firms, there must be a reasonable procedure for eligible small firms to enter the program, receive a prudent level of contract support and other assistance, and exit the program at an appropriate point in time. It must be understood that exit from the program may not always be successful completion. SBA can provide opportunity and assistance—ultimately present and future success of any business firm depends on itself.

We have, therefore, taken positive steps to effect improvement in the management of the 8(a) program with the limited resources which SBA has available. Some of these steps are:

One, we have instituted broad new policies to assure that all 8(a) portfolio firms are small by SBA size standards. Large business firms clearly are not authorized or eligible to participate in the 8(a) program. The Small Business Act, as amended by Public Law 95-507 and Public Law 96-481, clearly establishes the 8(a) program for small, socially and economically, disadvantaged firms. Quoting from section 7(j)(10) of the Small Business Act:

> There is established within the Administration a small business and capital ownership development program [hereinafter referred to as the "Program"] which shall provide assistance *exclusively for small business concerns* eligible to receive contracts pursuant to section 8(a) of this Act." [Emphasis added.]

We are mindful of the potential employment impact of terminating the large businesses currently in the program and believe a phaseout period of up to 1 year may in some cases be advisable.

Two, Public Law 96-481 requires the promulgation of regulations on the establishment of criteria and methodology for arriving at the mutually agreed upon fixed period for program participation. The law required such regulations to be issued in final form 120 days after its enactment. Upon arriving at SBA as Administrator, I found that this had not been done. However, a proposed regulation setting forth criteria and methodology for arriving at a mutually agreed upon fixed program participation date will be published in the Federal Register shortly. The public will have a full 30 days to comment on the proposed regulation. A separate regulation allowing for the establishment of an interim fixed program participation date for each program participant has been drafted and submitted to OMB for approval. It is expected that this second regulation will be published in sufficient time to allow for establishment of the interim dates prior to June 1, 1981. This will preclude the loss of contract support to the 8(a) portfolio.

Three, we have directed the staff to cease the issuance of procedural waivers to the standard operating procedure and to submit justification for approval only when a need for a waiver is clearly evident. Such direction was necessary to be certain that uniform and fair procedures were applied to all companies of the 8(a) portfolio.

Four, we placed a temporary moratorium on the acceptance of new applications for participation in the 8(a) program until a procedure could be developed to comply with section 106, Public Law 96-481. To implement that section requires the establishment of criteria for the basis on which the fixed period of time for program participation will be determined. We are currently in the process of developing the procedures and upon their implementation, including training of SBA field personnel, the moratorium will be lifted.

Five, we have issued directions that all requirement offerings from procuring agencies in excess of $2 million be referred to the central office. This is an administrative control established to guarantee fair and equitable matching to a small company qualified to perform. It is also a means to be certain that the offering is compatible with the business plan of the company selected by SBA's field offices and to insure that requirement offerings are spread fairly among all program participants. The need for the action is evidenced by the finding of GAO report CED 81-55, dated April 18, 1981, which stated:

> A small group of 8(a) firms, some of them competitive, have received the bulk of SBA's 8(a) contract dollars. About $1.7 billion, or 30 percent of the $5.5 billion of 8(a) contracts went to 50 active firms.

Additionally, SBA records indicate that during fiscal year 1980 approximately 620 8(a) concerns received no contract awards while the 8(a) goal of $1.6 billion was met. I have heard much criticism that this direction will damage the 8(a) program. I have heard that a cap of $2 million has been placed on offerings and none above that amount will be accepted. I have heard that goals will now not be met. These perceptions and allegations are false. We have directed MSB/COD central office staff to provide telecopier response to all referrals. There will be no slowdown—no capping—no reduction in SBA's effort to assist the small companies of the 8(a) portfolio. Allegations can only come from those who do not understand that delegations of authority based on dollar levels are a normal management tool in all Government procurement agencies and departments.

Six, we have established the policy that regional administrators may only approve the expenditure of business development expense funds up to 15 percent or $50,000 on a single 8(a) subcontract. Expenditures in excess of these amounts require approval of our central office.

The action to control more closely business development expense funds is the first step in formally implementing policies and corrective measures necessary to resolve abuses pointed out in SBA Inspector General reports. Specifically, in this instance, Audit Report No. 1-79, dated January 18, 1979, "Review of Business Development Expense (BDE)."

Seven, we have restructured the authorization level of the regional administrators in the use of advance payments. Any intended use of advance payments in excess of 40 percent or $100,000 on a single contract must be approved by our central office. Additionally the use of an advance payment on more than one 8(a) subcontract by a client at a time must be approved by our central office. This action is a prudent management decision based upon our Inspector General's audit report entitled "Advance Payments Made to Subcontractors Participating Under the SBA Section 8(a) Program" dated April 1979. This also is the first formal step aimed at preventing future abuses of the use of and the potential loss of the taxpayers' money in the advance payments area.

The above directions were issued on May 1, 1981, in an expeditious manner due to the tremendous need to stop the potential for abuse in the program and to immediately set the program on a path that will provide opportunity and assistance to a greater number of small, socially and economically disadvantaged firms. Those directions have since been incorporated formally into the program's standard operating procedure. Additionally, one required change to the SBA's rules and regulations is in the process of preparation for review at the Office of Management and Budget. A copy of the SOP is attached.

Mr. Chairman, we also submitted for insertion in the record our responses to the questions raised in the chairman's letter of May 8, 1981. I can highlight them:

The status of fiscal year 1981 goals for 8(a) firms and non-8(a) minority firms;

The moratorium on SBIC licenses;

The lack of outreach programs for minority businesses;

The lack of clear size standards for small and minority businesses;

The contract goal setting process for fiscal year 1981;

The lack of sufficient manpower in SBA's field operations; and

The failure of SBA to provide adequate training for its field operation.

We have included our response to your request of May 13, 1981, on the bills H.R. 3328 and 3330, which I will read——

Mr. MITCHELL. If I may interrupt you, I am fully aware of your response, but you might bring out the highlights in your response, for example the question of the status of your fiscal year 1981 goals.

Mr. CARDENAS. The 8(a) goal for fiscal year 1981 for all Federal procurement is $1.5 billion as compared to the fiscal year 1980 goal of $1.6 billion which was attained. As of the date of April 30, 1981, contracts in the aggregate amount of $560 million have been awarded as compared to the same period last year of $438 million. Comparison of 8(a) procurement activity this year with activities of previous years indicates that the goal should be reached.

Second, the moratorium on SBIC licenses. We have proceeded with approval of applications. At this point, we have approved at least two of them. We will continue as rapidly as possible to review the existing applications and will approve those that meet requirements where we feel we have adequate safeguards.

We are proceeding to work on the review of the safeguards for this program, and just as soon as I can satisfy myself that we have those procedures that are adequate to insure the protection of the other SBIC's, as well as to operate for the good of the small business communities, we will lift the moratorium on applications.

In the area of the lack of outreach programs for minority businesses, we are in the process also of reviewing the outreach programs. We do not believe they have been conducted as aggressively and as helpfully as was expected by Public Law 95-507. All I can say is we intend to step up our efforts in this area.

Question No. 4, the lack of clear size standards for small and minority businesses. We started back in 1980, where we published our first advanced notice of proposed standards. There has been much concern. We recently had a hearing and we will be going sometime in the future, after we receive more input and comment, to a second publication, after which there will be a 90-day period of comment prior to a proposed rule. So, that is something else that is in the mill.

Regarding the contract goal-setting process for 1982: The goal negotiation scheduled with all Federal agencies is now prepared for negotiation to occur in the fourth quarter of fiscal year 1981. Emphasis this year will be placed on the goals of the portfolio. We intend to place a greater emphasis on minority subcontracting and prime contracting.

The lack of sufficient manpower in SBA's field operation: We have full-time permanent positions of 4,383. We will have to reduce down to 4,218. It means reassigning some of the central staff to field offices—if we find upon review that we can better serve the business community by reassigning some of our central staff to the field, that will be given every consideration.

Seven, the failure of SBA to provide adequate training for its field operations: In 1979 over 3,000 employees were trained at a cost of almost $600,000; fiscal year 1981, 2,140 trained at a tuition cost of almost one-half of $1 million. This fiscal year, we expect to step up that training to include almost 4,000 employes at a tuition of a little over $800,000. We are looking into every area as to how we can improve that training. In fact the Department of Minority Small Business has an ongoing training program.

We feel that we have a good training program, but certainly we will be looking to every possible way that we can to be more productive and see how we can best develop this training.

Getting back to the bill H.R. 3330, which would terminate, effective June 1, 1981, the pilot program for small business set-asides under section 8(a). We do not support the passage of this bill. The pilot program with some changes in operational methods may be a valuable tool for obtaining certain types of contracts for 8(a) participants. The question of an additional extension of the pilot program beyond October 1, 1981, is under study within the executive branch at this time. We will be making a formal recommendation to you in the near future. But we do not favor the immediate termination as proposed in H.R. 3330.

H.R. 3328 would eliminate the 8(a) program entirely. We oppose passage of this bill. I want to reiterate, I believe in the 8(a) program and I oppose the passage of this bill. While previous management of the 8(a) program has clearly been inadequate and the implementing of significant changes in the program is mandatory, we believe it is a valuable and much needed program of assistance for small socially and economically disadvantaged firms.

I assure you that it is not the intent of SBA or the Reagan administration to diminish the effectiveness of the 8(a) program or to reduce efforts to assist small minority businesses. On the contrary, the actions we have taken and will take are positive steps to assure continuation of the program, to assure full compliance with the law, and to provide assistance and opportunity to a much greater number of small socially and economically disadvantaged firms.

Mr. Chairman, this concludes my prepared statement. I will be happy to answer any questions the subcommittee may have.

I would like to introduce to the committee, Mr. Don Templeman, SBA Deputy Administrator, and Dr. Robert L. Wright, the Associate Administrator in charge of minority small business and capital ownership development.

[Mr. Cardenas' prepared statement with attachments follows:]

PREPARED STATEMENT OF MICHAEL CARDENAS, ADMINISTRATOR, SMALL BUSINESS ADMINISTRATION

I wish to express my appreciation to the Chairman for the invitation to appear before the Small Business Committee to discuss important issues relating to the SBA small business programs and the 8(a) program for small socially and economically disadvantaged entrepreneurs and SBA's management of the programs.

Before being appointed as Administrator of the Small Business Administration, I knew that the 8 (a) program was one of the most controversial, misunderstood and maligned programs of SBA. Yet I strongly believe as does the Reagan Administration that SBA has an important mission and responsibility to provide assistance and opportunity to those small socially and economically disadvantaged entrepreneurs who wish to become business persons.

Before I could set the course for a better program delivery system it was necessary to study the current and past problems, the criticisms of the public, the Congress and the many investigations by GAO, and the SBA Inspector General. I found that for several years the same problems have continued to reappear with minimal remedial action having been taken. I also found that the 8(a) program had undergone since inception development by administrative decision ranging from a test cities program, a job employment program to a program for entrepreneurs. It was not until October 24, 1978, ten years after the program's inception, that the Congress defined in Public Law 95-507 the sincere concern that assistance to minority small businesses was an essential necessity for the free enterprise system and better economic development of these United States. The passage of Public Law 96-481 further enhanced and defined the program direction in support of small minority business. Both laws were helpful to a better understanding of program direction and compatible with the Administration's viewpoint concerning the assistance required by the small minority business community.

As Administrator of SBA, my role is to ensure that rules and regulations, program operating procedures and program direction are adequate to implement the law. When I arrived at SBA I found that existing direction, rules and regulations and operating procedures did not fully reflect the intent of the Small Business Act. I also found the work on the new regulations required by Public Law 96-481 was not progressing in accordance with the schedule specified in the law.

I believe that no mission or program can attain optimum success or cost effectiveness without strong management direction. It is my intent to address those areas where problems continue to exist and to expand program participation opportunity to the greatest number of *small* socially and economically disadvantaged businesses.

In order to provide proper 8(a) program opportunity to thousands of deserving eligible small disadvantaged firms, there must be a reasonable procedure for eligible small firms to enter the program, receive a prudent level of contract support and other assistance, and exit the program at an appropriate point in time. It must be understood that exit from the program may not always be successful completion. SBA can provide opportunity and assistance—ultimately present and future success of any business firm depends on itself.

We have, therefore, taken positive steps to effect improvement in the management of the 8(a) program with the limited resources which SBA has available. Some of these steps are:

1. We have instituted broad new policies to assure that all 8(a) portfolio firms are small by SBA size standards. Large business firms clearly are not authorized or eligible to participate in the 8(a) program. The Small Business Act as amended by Public Law 95-507 and Public Law 96-481 clearly establish the 8(a) program for small socially and economically disadvantaged firms. Quoting from Section 7(j)(10) of the Small Business Act: "There is established within the Administration a small business and capital ownership development program (hereinafter referred to as the 'Program') which shall provide assistance *exclusively for small business concerns* eligible to receive contracts pursuant to Section 8(a) of this Act." (emphasis added)

We are mindful of the potential employment impact of terminating the large businesses currently in the program and believe a phase out period of up to one year may in some cases be advisable.

2. Public Law 96-481 requires the promulgation of regulations on the establishment of criteria and methodology for arriving at the mutually agreed upon fixed period for program participation. The law required such regulations to be issued in final form 120 days after its enactment. Upon arriving at SBA as Administrator, I

found that this had not been done. However, a proposed regulation setting forth criteria and methodology for arriving at a mutually agreed upon Fixed Program Participation date will be published in the Federal Register shortly. The public will have a full thirty days to comment on the proposed regulation. A separate regulation allowing for the establishment of an interim Fixed Program Participation date for each Program participant has been drafted and submitted to OMB for approval. It is expected that this second regulation will be published in sufficient time to allow for establishment of the interim date prior to June 1, 1981. This will preclude the loss of contract support to the 8(a) portfolio.

3. We have directed the staff to cease the issuance of procedural waivers to the Standard Operating Procedure and to submit justification for approval only when a need for a waiver is clearly evident. Such direction was necessary to be certain that uniform and fair procedures were applied to all companies of the 8(a) portfolio.

4. We placed a temporary moratorium on the acceptance of new applications for participation in the 8(a) program until a procedure could be developed to comply with Section 106, Public Law 96-481. To implement that section requires the establishment of criteria for the basis on which the fixed period of time for program participation will be determined. We are currently in the process of developing the procedures and upon their implementation, including training of SBA field personnel, the moratorium will be lifted.

5. We have issued directions that all requirement offerings from procuring agencies in excess of $2,000,000 be referred to the Central Office. This is an administrative control established to guarantee fair and equitable matching to a small company qualified to perform. It is also a means to be certain that the offering is compatible with the business plan of the company selected by SBA's field offices and to ensure that requirement offerings are spread fairly among all program participants. The need for the action is evidenced by the finding of GAO Report CED 81-55, dated April 18, 1981, which stated, "a small group of 8(a) firms, some of them competitive, have received the bulk of SBA's 8(a) contract dollars. About $1.7 billion, or 30 percent of the $5.5 billion of 8(a) contracts went to 50 active firms." Additionally, SBA records indicate that during fiscal year 1980 approximately 620 8(a) concerns received no contract awards while the 8(a) goal of $1.6 billion was met. I have heard much criticism that this direction will damage the 8(a) program. I have heard that a cap of $2,000,000 has been placed on offerings and none above that amount will be accepted. I have heard that goals will now not be met. These perceptions and allegations are false. We have directed MSB/COD Central Office staff to provide telecopier response to all referrals. There will be no slow down—no capping—no reduction in SBA's effort to assist the small companies of the 8(a) portfolio. Allegations can only come from those who do not understand that delegations of authority based on dollar levels are a normal management tool in all government procurement agencies and departments.

6. We have established the policy that Regional Administrators may only approve the expenditure of Business Development Expense funds up to 15 percent or $50,000 on a single 8(a) subcontract. Expenditures in excess of these amounts require approval of our Central Office.

The action to control more closely Business Development Expense funds is the first step in formally implementing policies and corrective measures necessary to resolve abuses pointed out in SBA Inspector General reports. Specifically, in this instance, Audit Report No. 1-79. dated January 18, 1979 "Review of Business Development Expense (BDE)."

7. We have restructured the authorization level of the Regional Administrators in the use of advance payments. Any intended use of advance payments in excess of 40 percent or $100,000 on a single contract must be approved by our Central Office. Additionally the use of an advance payment on more than one 8(a) subcontract by a client at a time must be approved by our Central Office. This action is a prudent management decision based upon our Inspector General's audit report entitled "Advance Payments Made to Subcontractors Participating under the SBA Section 8(a) Program" dated April 1979. This also is the first formal step aimed at preventing future abuses of the use of and the potential loss of the taxpayers' money in the advance payments area.

The above directions were issued on May 1, 1981, in an expeditious manner due to the tremendous need to the stop potential for abuse in the program and to immediately set the program on a path that will provide opportunity and assistance to a greater number of small socially and economically disadvantaged firms. Those directions have since been incorporated formally into the program's Standard Operating Procedure. Additionally, one required change to the SBA's Rules and Regulations is in the process of preparation for review at the Office of Management and Budget. A copy of the SOP is attached.

Our responses to the questions raised in the Chairman's letter of May 8, 1981, are as follows:

1. THE STATUS OF FISCAL YEAR 1981 GOALS FOR 8(a) FIRMS AND NON-8(a) MINORITY FIRMS

The 8(a) goal for fiscal year 1981 for all federal procurement is $1.5 billion as compared to the fiscal year 1980 goal of $1.6 billion which was attained. As of the date of April 30, 1981, contracts in the aggregate amount of $560,000,000 have been awarded as compared to the same period last year of $438,000,000. Comparison of 8(a) procurement activity this year with activities of previous years indicates that the goal should be reached.

For non-8(a) minority firms, all civilian agencies report semi-annually to the General Services Administration concerning prime and subcontracting programs and GSA then publishes the semi-annual report of progress. This information has not been published for the first six-month period. The Department of Defense publishes military procurement figures on a quarterly basis. The second quarter figures have not been published or distributed. It does appear, however, that military procurements for small and disadvantaged firms will approximate the prime and subcontracting procurements of the previous fiscal year.

2. THE MORATORIUM ON SBIC LICENSES

Upon assuming the position of Administrator of SBA, I was briefed by the Inspector General on a number of problem areas including the Small Business Investment Company program. It was readily apparent from that briefing and other information received from the acting manager of the program that there are serious problems in the SBIC area. I was convinced that under program direction and guidelines in effect at that time there was the strong probability that taxpayers' funds could be improperly used. It was also likely that some existing SBICs and MESBICs, and some in the licensing process might not serve the best interest of small business firms they are intended to help. Therefore, I placed a temporary moratorium on further licensing, pending a review of the program. That review is currently in process. Of first concern in the review of the SBIC program was the further processing of applications for licenses then in process. After determining that, with the addition of a few safeguards and input from district directors in the field, adequate protection could be afforded the taxpayers' money and the interests of the small businesses, that would be involved, on April 28, 1981, I lifted the moratorium for applications in process. Therefore, applications in process as of April 17, 1981, are now being acted upon. The moratorium on new applications for SBIC licenses will remain in effect until I am satisfied that the program has been restructured to minimize the potential for abuse in the areas.

3. THE LACK OF OUTREACH PROGRAMS FOR MINORITY BUSINESSES

We are reviewing the outreach programs and do not believe they have been conducted as aggressively as envisioned by Public Law 95-507. We intend to increase SBA's efforts in this area. Some efforts were initiated by the prior Administration. The efforts of advocating and promoting outreach programs is a continuing one at the Central Office and field operational levels. SBA has promoted a substantial program with minority trade associations to expand their sphere of operation and assistance to minority companies. Outreach is also provided by marketing agreements with three major corporations who readily cooperate with the various minority companies referred as potential suppliers. We intend to monitor closely the cooperation and success of these agreements. While looking into the successes as well as the problems of this effort, SBA intends to pursue additional corporate agreements utilizing the experiences of these first negotiations with A&P, Western Electric and McDonnell Douglas. The Presidential Advisory Council was a group appointed for the purpose of advising and recommending methods for employing intercommunity participation of government and industry in promoting greater minority business potential. Employees of SMA continuously meet with community action groups and expound on the program available through the federal sector. In addition, we are working cooperatively with the Minority Business Development Agency to expand all outreach programs particularly including assistance to 8(a) program companies that have completed program participation.

4. THE LACK OF CLEAR SIZE STANDARDS FOR SMALL AND MINORITY BUSINESSES

Before I address the question, it is necessary to define exactly what the phrase "size standard" means. As used by the SBA, it is the measure of eligibility for SBA assistance programs. It acts as a screening device to channel assistance to firms below the size standard cutoff. These are the firms which the Small Business Act, as amended, directs the SBA to assist.

During the past 25 years, the current size standards have evolved through competing pressures of various trade associations and political groups representing different points of view. In the past, there has been no unifying viewpoint linking the various size standards. On March 10, 1980, the SBA published its first advance notice of proposed rulemaking designed to update and improve the logic, methodology and presentation of its entire size standard program. Public response to the proposed change was generally critical, mainly because the changes would affect the eligibility of firms for SBA assistance. As a result, of the interest generated, the comment period was extended and public hearings were held in each of our 10 regions. In total we received over 1,500 comments and the comments involved about 200 of the 800 different industries under review.

Based upon the information derived from the comments, SBA hearings, and hearings before the Senate Committee on Small Business, we are reevaluating many of the initially proposed standards. We believe that the size standards will never be completely set in concrete but will require periodic review and analysis. Any notice, when published, will provided a 90-day period of public comment prior to a proposed rule. The final rule, when published, will provide a 6-month grace period before going into effect, to provide affected firms and agencies additional time to adjust to the changes.

Notwithstanding our intention to review and revise the size standards, the current size standards under CFR Part 121 are clear and are based upon the industrial base of the Nation. The current system has worked and is working for both small and small socially and economically disadvantaged business concerns.

5. THE CONTRACT GOAL SETTING PROCESS FOR FISCAL YEAR 1981

Goal setting plans have been formulated for fiscal year 1982 and the goal negotiation schedule with all federal agencies is now prepared for negotiation to occur the fourth quarter of fiscal year 1981. Emphasis this year will be placed on the 8(a) program goals in relation to the aggregate business plan requirements of the portfolio companies. A greater emphasis in goal negotiation will be directed to minority participation in subcontracting and prime contracting.

6. THE LACK OF SUFFICIENT MANPOWER IN SBA'S FIELD OPERATIONS

The SBA is currently authorized 4,383 full-time permanent positions. For fiscal year 1982, we must reach the level of 4,218 positions. Within these overall constraints, we are reviewing personnel levels for all programs and areas. One of the specific areas we are reviewing is the Central Office personnel as compared to the field activities. It is possible that some positions will be transferred from the Central Office to field activities. Additionally, we are reviewing vacant positions in the field to determine those that can be filled immediately within the guidelines for overall personnel ceilings. The Minority Small Business and Capital Ownership Development program currently has 67 positions in the Central Office and 307 positions in the field.

7. THE FAILURE OF SBA TO PROVIDE ADEQUATE TRAINING FOR ITS FIELD OPERATION

During the past several years, the SBA has expended considerable efforts and tuition dollars for training. In fiscal year 1979, 3,010 employees were trained at a cost of $599,878, fiscal year 1981, 2,141 employees were trained at a tuition cost of $489,257; and this fiscal year we project 3,893 employees at a tuition cost of $837,000.

Currently major training emphasis planned for fiscal year 1982-83 are on a basis of programmatic needs of employees. The plan is based upon a review of the programs, needed skills, knowledges and abilities as perceived and described by the program managers of the Agency. For MSB/COD on-going training is now underway for employees in financial analysis, procurement contracts and contract negotiations.

We are proud of the training to date but feel that this area must also be reviewed to ascertain if a better, more productive way can be found and developed.

In response to the Chairman's request of May 13, 1981, I will now comment on H.R. 3328 and H.R. 3330.

H.R. 3330 would terminate, effective June 1, 1981, the pilot program for small business set-asides under Section 8(a). We do not support the passage of this bill. The pilot program with some changes in operational methods may be a valuable tool for obtaining certain types of contracts for 8(a) participants. The question of an additional extension of the pilot program beyond October 1, 1981 is under study within the Executive Branch at this time. We will be making a formal recommendation to you in the near future. But we do not favor the immediate termination as proposed in H.R. 3330.

H.R. 3328 would eliminate the 8(a) program entirely. We oppose passage of this bill. While previous management of the 8(a) program has clearly been inadequate and the implementing of significant changes in the program is mandatory, we believe it is a valuable and much needed program of assistance for small socially and economically disadvantaged firms.

I assure you that it is not the intent of SBA or the Reagan Adminstration to diminish the effectiveness of the 8(a) program or to reduce efforts to assist small minority businesses. On the contrary, the actions we have taken and will take are positive steps to assure continuation of the program, to assure full compliance with the law and to provide assistance and opportunity to a much greater number of small socially and economically disadvantaged firms.

Mr. Chairman, this concludes my prepared statement. I will be happy to answer any questions the Subcommittee may have.

SMALL BUSINESS ADMINISTRATION
STANDARD OPERATING PROCEDURE
NATIONAL

SUBJECT:	S.O.P. SECTION	S.O.P. NO.	REV
MINORITY SMALL BUSINESS AND CAPITAL OWNERSHIP DEVELOPMENT PROGRAM	80	05	A

Introduction

1. Purpose. To provide procedures pertaining to the authority of Regional Administrators in the use of business development expense, advance payments, requirements offering matching process with 8(a) approved companies, and waivers.

2. Personnel Concerned. All Central Office and field personnel covered by this SOP.

3. Page Changes.

Remove	Insert
11 - 14	11 - 14
103 - 104	103 - 104
131 - 132	131 - 132
139 - 140	139 - 140

4. Distribution. Standard

5. Originator. Associate Administrator, Minority Small Business and Capital Ownership Development.

AUTHORIZED BY		EFFECTIVE DATE
MICHAEL CARDENAS ADMINISTRATOR		5-18-81
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(2) Develops targets, objectives, and plans for the execution of the MSB&COD programs.

(3) Allocates Business Development Expense (BDE) funds to the regions.

(4) Approves or declines requests for Business Development Expense Funds in excess of $350,000, or over 50 percent of the total value of the contract.

(5) Develops staffing guidelines and allocates resources to the regions.

(6) Coordinates with and enlists the support of other Central Office program officials to provide a coordinated thrust of all SBA programs in assisting minority and disadvantaged owned firms.

(7) Reviews and evaluates program effectiveness.

(8) Conducts periodic reviews of all concerns participating in MSB&COD programs and all SBA field offices responsible for MSB&COD program operations. Recommends improvements and follows up on the status of implementation.

(9) Advises regional offices of potential national buy requirement support projections prior to submission of 8(a) applications.

(10) Coordinates all national buy requirements sought by regions for subsequent negotiation and award to support 8(a) concern's business plans.

(11) Provides technical advice and guidance to the field offices.

(12) Maintains liaison and coordinates with other Federal departments and agencies to encourage national assistance for the MSB&COD programs.

(13) Encourages and obtains involvement and commitments of industrial concerns, financial institutions, professional and trade associations, Federal, state and local governments to support and provide ongoing assistance to minority and disadvantaged owned concerns.

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(14) Approves, declines or recommends modifications required in management and joint venture agreements involving 8(a) concerns.

(15) Makes final decisions on 8(a) program eligibility.

(16) Develops short and long range training plans for MSB&COD personnel.

(17) Evaluates the impact of national economic trends and other indicators on MSB&COD programs, and implements necessary changes.

(18) Makes final decision on program completion and termination appeals.

* (19) Authority to waive any portion of 8(a) program procedures is reserved to the Administrator, however, the 8(a) program shall be managed by the Associate Administrator for Minority Small Business and Capital Ownership Development under the supervision of, and responsible to, the Administrator. Regional Administrators may recommend with written justification, the granting of a waiver to the AA/MSB-COD where in their opinion a need exists. The AA/MSB-COD as manager of the 8(a) program, shall analyze and determine the merit of the suggested waiver and shall exercise his authority as 8(a) program manager to disapprove waivers or to recommend approval to the Administrator of a waiver utilizing SBA Form 606. *

b. Regional Offices

The regional administrator is responsible to the Administrator for all MSB&COD program activities within the region. The regional administrator receives technical advice and guidance in the development of the MSB&COD programs from the Associate Administrator for Minority Small Business and Capital Ownership Development (AA/MSB&COD). Supervision of the program is executed by the regional administrator through the Assistant Regional Administrator for Minority Small Business and Capital Ownership Development (ARA/MSB&COD). In conformance with SBA's policy of decentralization, regional administrators may grant in writing to district offices such authority as may be deemed necessary and prudent for implementation of the MSB&COD programs except for those

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nondelegable limitations set forth elsewhere in this SOP and the Agency delegations of authority. All delegations and designations of authority, including exceptions, must be made in accordance with and pursuant to the provisions of SOP 00-01 "Delegation of Authority and Designation".

(1) Implements and administers the regional MSB&COD programs.

(2) Plans, develops, promotes, stimulates, executes, and coordinates all SBA programs in assisting minority and disadvantaged owned concerns. Provides for ongoing management, marketing, financial, procurement and technical assistance to these concerns and coordinates the provision of assistance by outside sources.

(3) Evaluates the region's overall efforts in meeting MSB&COD program objectives, targets and goals.

(4) Monitors and evaluates district office performance in the implementation of the MSB&COD programs and develops plans for improvement.

(5) Directs and coordinates the activities of the district minority small business, business development and contract specialists, assesses and provides training needs for each.

(6) Develops systems and controls to ensure the effective utilization of the district MSB&COD personnel.

(7) Provides technical advice and guidance to the district offices.

(8) Recommends to the AA/MSB&COD approval or decline of applications for participation in the 8(a) program based on eligibility criteria contained in the rules and regulations and this SOP. Reviews and ensures adequacy of documentation establishing social and economic disadvantage.

(9) Coordinates all intraregional local buy requirements.

(10) Coordinates all interregional local buy requests with each region where the procurement is located.

(11) Coordinates with the Central Office all regional requests for national buy requirement support.

* (12) Ensures that BDE funds are used by the 8(a) concerns for the purposes intended. *

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(13) Reviews, evaluates and recommends approval or disapproval of all sponsorsnip, management and joint venture agreements to the AA/MSB&COD.

(14) Approves or declines requests for advance payments and ensures the orderly and timely liquidation of such advances.

(15) Approves or declines modifications to the business plans.

(16) Negotiates, executes and administers 8(a) contracts and subcontracts.

C. District Offices

(1) Plans, develops, promotes, stimulates, executes and coordinates all SBA programs in assisting minority and disadvantaged owned concerns. Provides for ongoing management, marketing, financial, procurement and technical assistance to these concerns; coordinates the provision of assistance by outside resources; and approves or declines requests for loans by 8(a) concerns.

(2) Counsels and provides guidance to individuals desiring to participate in the MSB&COD programs.

(3) Reviews and makes recommendations regarding eligibility of program applicants based on criteria contained in the rules and regulations and this SOP.

(4) Reviews, evaluates and makes recommendations on all sponsorship, management, joint venture agreements, and forwards them, along with documentation and justification, to the regional administrator.

(5) Reviews, evaluates and recommends approval or disapproval of 8(a) applications.

(6) Delegates subcontract administration responsibilities to the procuring activity, as appropriate.

(7) Recommends approval or decline to the regional administrator's requests for advance payments and BDE funds. Ensures the orderly and timely liquidation of advance payments and the use of BDE for the purposes intended.

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d. Acceptance of National Buy Requirements

OBD, Central Office shall be solely responsible for the acceptance of national buy requirements. Any national buy requirement offered by a procuring activity directly to a field office shall be immediately referred to the Program Acquisition Division, OBD, Central Office.

e. Acceptance of Requirement Offerings Exceeding $2,000,000

Prior to formal assignment of any federal agency requirement offering in excess of $2,000,000 the District Director and the regional administrator shall analyze the regional portfolio of 8(a) companies to determine the appropriate company qualified to perform a subcontract of this size. The analysis should be based upon, but not solely limited to, the following factors:

(1) business plan compliance

(2) capacity and capability to perform

(3) ability to deliver in a timely manner

(4) number of contracts and dollar amount of contracts previously issued and the performance record of each contract

(5) current contracts in process and progress for timely delivery

(6) other potential contracts under consideration

(7) years in the program and anticipated program completion date

(8) BDE and advance payment support since entering the 8(a) program

(9) other factors supporting selection

(10) names of two other companies capable of performing

The analysis with recommendation, including comments of the District Director and the ARA/MSB-COD, shall be submitted by the Regional Administrator to the AA/MSB-COD. This function

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* of the 8(a) program shall be managed by the Associate Administrator for Minority Small Business and Capital Ownership Development under the supervision of, and responsible to, the Administrator.

To expedite notification of acceptance or rejection of the requirement to the offering agency, response will be furnished by telecopier from the office of the AA/MSB-COD to the Regional Administrator. *

55. CONTRACTUAL ASSISTANCE LIMITATIONS

a. Business Plans

The business plan must include a statement setting forth the size standard for the concern based upon its principal business activity. It should also document that the 8(a) subcontract assistance requested will foster or expand the concern's capabilities to participate in the economy as a self-sustaining, profit-oriented small business.

b. Subcontracting Assistance

The total dollar amount of 8(a) subcontracts and modifications awarded within the concern's fiscal year shall be considered in determining if it has reached the limit of approved 8(a) support for that year. A dollar limitation for all concerns will be based on the amount approved for the business plan. SBA shall ensure that participating concerns will not depend solely upon 8(a) subcontracting support, but will be required to generate non-8(a) business to meet the concern's business development objectives.

c. Research and Development (R&D)

Service concerns claiming their primary business is Research and Development (R&D) must provide evidence that at least 51 percent of the concern's total business during the last 2 years was in the area of R&D. Newly started service concerns may be classified R&D after 2 years in business at which time they shall be required to submit the evidence described above.

56. COORDINATION OF EFFORT

It is necessary that there be full coordination and cooperation between all SBA organizational units (Central and Field Offices) in identifying and securing local and national buy requirements.

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a. Local Buy Requirements

Construction and non-professional service requirements are within the jurisdiction of the region where the work is to be performed. Requirements not suited for matching within a region should be offered to adjacent regions for consideration. Requirements marketed outside of a concern's region will require concurrence of the region in which the work is to be performed.

b. National Buy Requirements

The Director, OBD or designee shall be responsible for coordinating national buy requirements. District and regional personnel are also responsible for contacting national buying centers for the purpose of identifying and/or locating needed requirements. If a procurement opportunity is identified by SBA regional or district personnel, OBD Central Office shall be advised immediately.

57. RESPONSIBILITY - NATIONAL BUY REQUIREMENTS

a. The Director, OBD or designee shall:

(1) Seek and stimulate the cooperation and participation of other government agencies in the 8(a) program.

(2) Maintain continuous contact with appropriate procurement agency officials to inform them of program goals, policies, and procedures.

(3) Encourage the consideration and selection of approved 8(a) concerns for non 8(a) contracts.

(4) Compile and analyze statistical data for requirements management and planning.

(5) Develop annual forecasts of required national buy support necessary to meet the needs of 8(a) clients.

(6) Perform technical analysis of the capabilities of 8(a) concerns to evaluate their ability to perform on specific requirements.

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CHAPTER 9

ADVANCE PAYMENTS

89. GENERAL

Advance payments are authorized by 41 U.S.C. 255. Advance payments are disbursements of money made by SBA to a section 8(a) business concern prior to the completion of performance of a specific 8(a) subcontract. They are made for the purpose of assisting the section 8(a) business concern in meeting financial requirements pertinent to the performance of the subcontract.

Advance payments may be made only in instances where they are determined by the regional administrator to be in the public interest, upon adequate security and when the subcontractor's accounting system provides effective control over and accountability for funds. Security shall be in the form of a lien in favor of the government paramount to all other liens upon the property contracted for, upon the balance in an account in which such payments are deposited and upon property acquired for the performance of the subcontract.

Advance payments must be liquidated from proceeds derived from the performance of the specific 8(a) contract. However, this does not preclude repayment of such advances from other revenues of the business, except from other advance payments and business development expense funds.

The proceeds derived from the performance of the specific section 8(a) subcontract must be deposited by the procuring agency in a special bank account established exclusively for the purpose of administering advance payments. These proceeds must be used to liquidate the advance payments.

Advance payments shall not be made to a section 8(a) business concern in any case in which the section 8(a) concern has assigned its rights to receive any payment under the specific section 8(a) subcontract to any person or entity.

* All appropriate regional personnel shall be advised by the regional administrator that regional approval authority for advance payment use is limited to the lesser of: *

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* a. 40% of a single contract, or

b. $100,000 on a single contract, and

c. one advance payment may be used on an 8(a) subcontract only in instances where no other advance payments or progress payments are in use by the same company on another 8(a) subcontract.

In each instance where a regional administrator believes a greater use of an advance payment is warranted, it shall be the responsibility of the regional administrator to submit a written justification and recommendation to the AA/MSB-COD. The justification shall include a complete review and study of the financial statement of the company to determine the need for approving an advance payment. The review shall identify all previous contracts awarded to the company, advance payments authorized, progress payments authorized, record of repayment of each and the reasons for a continuing need for this form of support from SBA as well as the potential assistance that could be substituted by utilizing advance payments/progress payments of the procuring activity. The justification should be supported by concurrences of the District Director and the ARA/MSB-COD. Advance payment requests shall be submitted to the AA/MSB-COD. This function of the 8(a) program shall be managed by the Associate Administrator for Minority Small Business and Capital Ownership Development under the supervision of, and responsible to, the Administrator. *

The SBA shall not charge interest on advance payments disbursed pursuant to these regulations.

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90. POLICY

Advance payments may be approved for a section 8(a) business concern when all of the following conditions are found by SBA to exist:

a. A section 8(a) business concern does not have adequate working capital to perform a specific section 8(a) subcontract.

b. Either adequate and timely financing is not available on reasonable terms to provide necessary capital, or financing is available, but the terms of such financing are not conducive to the effective business development of the section 8(a) concern.

c. The section 8(a) concern has established or agrees to establish and maintain financial records and controls which will provide for complete accountability and required reporting of advance payment funds. These records must be made available upon request for review by SBA and the General Accounting Office.

91. PROCEDURES

a. Application for Advance Payments

A section 8(a) concern desiring to obtain advance payments in connection with any section 8(a) subcontract shall submit a written request to the appropriate regional administrator. Such a request must include the following detailed documentation:

(1) Justification of the need for advance payments.

(2) Evidence that working capital financing cannot be found upon terms discussed in paragraph 90 b.

(3) A cash flow forecast for the specific 8(a) subcontract.

(4) Identification of the amounts of advance payments that will be needed for specific purposes such as materials,

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CHAPTER 10

BUSINESS DEVELOPMENT EXPENSE

94. PHILOSOPHY

The 8(a) program is a business development program. An integral part of this development process is the use of business development expense in appropriate circumstances to allow 8(a) concerns to obtain a reasonable profit in the performance of subcontracts and to purchase needed capital equipment for efficiency and growth.

Business development expense can be an effective tool to assist 8(a) concerns to overcome problems related to small size, efficiencies of scale, pricing and lack of access to credit and capital. Appropriate management safeguards as outlined below shall be followed.

95. DEFINITIONS

a. Business Development Expense (BDE)

A payment to an 8(a) concern in the interest of the concern's development, approved by the designated SBA official, and restricted to certain approved uses.

b. Fair Market Price

The fair market price represents that price at which a procuring activity could most likely purchase articles, supplies, services, etc. using normal purchasing procedures. Ultimately the fair market price is reflected as the negotiated price arrived at between SBA and the procuring activity and included in the prime contract.

c. Price Differential

The difference between:

(1) The unit price(s) in the prime contract between SBA and the procuring activity, and

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(2) The unit price in the subcontract between SBA and the 8(a) concern. Where the supplies, services, etc. are not unit-priced in the contract/subcontract, the price differential is the difference between the aggregate amounts of the prime contract and subcontract.

96. APPROVED USES OF BDE

* All appropriate regional personnel shall be advised by the regional administrator that regional approval authority for use of BDE is limited to the lesser of:

a. 15% of a single contract, or

b. $50,000 on a single contract, and

c. one BDE approval to an individual contractor.

In each of the three instances where the use of BDE would exceed regional authority and the regional administrator believes extenuating circumstances exist which justifies a greater use of BDE, it shall be the responsibility of the regional administrator to submit a complete analysis, detailed justification and recommendation to the AA/MSB-COD. The analysis shall contain a complete review of previous issuances of BDE to the same company including purpose and dollar amount, the current need for additional BDE support, a financial analysis that clearly indicates that BDE is the only remaining source of financial assistance, a determination that a duplicative request is not being made and written justification that clearly identifies that a sincere requirement for supplemental assistance exists. The justification should be support by concurrence of the District Director and the ARA/MSB-COD. BDE requests shall be submitted to the AA/MSB&COD. This function of the 8(a) program shall be managed by the Associate Administrator for Minority Small Business and Capital Ownership Development under the supervision of, and responsible to, the Administrator. *

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S.O.P. CONTINUATION SHEET	S.O.P. SECTION	S.O.P. NO.	REV
	80	05	A

a. Price Differential

As defined in paragraph 95c and limited in paragraph 97.

b. Capital Equipment

An 8(a) concern having need for the purchase of capital equipment to perform a specific contract shall make written application to the Regional Administrator justifying the need, delineating the financial condition which precludes normal borrowing from financial institutions or establishes that borrowing would adversely affect company advancement and jeopardize its normal development.

Acquisition in whole or in part of such equipment and machinery is of significant importance to the development of the 8(a) concern and is also essential to the 8(a) concern's performance of the specific subcontract subject to the provisions of paragraph 97e.

Where capital equipment is purchased with front-end BDE, SBA shall retain a lien on the property in the form of title or otherwise as appropriate, pending completion of the contract and repayment of any funds due to SBA.

c. Defray Cost

BDE is intended to enhance the concern's ability to meet its business objectives as outlined in the concern's approved business development plan. Consequently, BDE may also be used to defray other costs necessary for performance of a specific 8(a) subcontract, as follows:

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Mr. MITCHELL. Thank you very much for a comprehensive and definitive statement. I am delighted that other Congressmen have joined us, Congressman Staton, Congressman Smith, and Congressman Crockett. With this many members present, we will stick to the 5-minute rule.

First of all, I am delighted by the statement on page 2, your closing-out statement reaffirming the administration's support for minority business. You opened up with that kind of statement, also. I think it is excellent. I, frankly, would like to see the President issue such a statement, because of some of the confusion that now exists in Government and the private sector.

Strangely enough, although I am a Democrat and I work very hard for small business, minority business, many of the minority businesses are Republican. They have been very supportive of the President, and I would hope that at some time in the near future, such a statement would come from the White House. I think it would be very, very beneficial in eliminating or diminishing some of the concerns and frustrations that you and I both hear on a day-to-day basis.

On page 5 in your testimony, you indicated that you did not want to move for an abrupt termination of some of these larger firms because you recognize the potential, you say, the potential for employment. It really is a potential for unemployment that would result as a result of an abrupt termination.

That means you made an impact study; is that correct?

Mr. CARDENAS. Mr. Chairman, it was alluded to that it would result in *x* number of unemployment. I think that figure was used for the total number of employees, taking into consideration all the contractors involved in the 8(a) program. However, I look at it as a source of new employment, in that as you terminate many of these businesses which we expect will be able to continue on a competitive basis, and therefore continue to expand themselves, we would hope that they would normally continue their level of employment. This would, in turn, give the smaller firms an opportunity to come into the mainstream and build up their business. So I see it as an increase in employment in the end.

Mr. MITCHELL. Do you have a precise figure? I think there would be a loss of employment if there were to be an abrupt termination, and you testified there would not be an abrupt termination. I think there would be a significant loss of jobs, and later on I will present some data indicating the percentage of lost jobs.

On page 6 of your testimony, where you were talking about the—rather pages 6 and 7, where you talk about the moratorium, and you indicated you wanted that to be lifted as quickly as possible. Would you give me a more precise target date you would aim for in terms of lifting that moratorium?

Mr. CARDENAS. We had used a targeted date of around September of this year, Mr. Chairman.

Mr. MITCHELL. And one last question in my first 5 minutes, it is not really a question but a request. You will put out your new regulations on graduation. As I understand it in your testimony, you indicated there would be a 30-day comment period. I would like to see a longer period for comment, 45 to 60 days, because it is a very, very important issue and I think on the more important issues, we try to give maximum time for comment. So I would request of you that you reconsider the length of time for comment on the graduation and move it to a maximum period of 45 to 60 days.

That is merely a request I make of you.

Mr. Staton?

Mr. STATON. Thank you, Mr. Chairman.

Mr. Cardenas, thank you for being here. We appreciate your testimony.

In your May 1 statement you indicated that one of the most severe problems facing the 8(a) program is that of large firms participating in this program.

Can you share with us any of the evidence that you have seen indicating the presence of firms in the program which exceeds the industry size standard?

Mr. CARDENAS. Well, I have not picked on any one set of firms, but it is quite evident from the participation that a small percentage enjoy a large percentage of the contracts. All I am saying is that we will review each and every one of the 8(a) contractors in the program and certainly will apply the size standards.

Mr. STATON. Pages 12 and 13 of your statement, you discuss the problems in the small business investment company program. Can you be a little more specific as to the nature of these problems?

Mr. CARDENAS. It was originally my finding that our employees in the field, particularly the district director, did not have enough input into the matter, whether the licensees-to-be were qualified and could conduct an SBIC program in that small business community without bringing some harm to the small business community.

In other words, my feeling is that all these programs should be taken into consideration to help the small business community, not to bring any ill feeling or harm to the agency in any way or form. All I wanted to reassure was that there was no room for abuses. After discussing it with the inspector general of our agency, he clearly pointed out to me the very strong charges of abuses. So, I immediately set this moratorium to be able to review and discuss with central staff and issue out the directions to the field, which we have done. You have probably read the report where I have been proceeding to review all those applications that are in process and in the near future. We will also lift the moratorium in its entirety. I just wanted to be sure we had a handle on things.

Mr. STATON. You indicated you would lift the moratorium in September?

Mr. CARDENAS. It might be a little longer on this one or earlier, depending—in other words, the first two applications that have been submitted to me with all the background information, I have approved. Now if it looks like things are going well and I receive a report soon from the field and central office in which they can assure me we will have adequate controls for review of the program, then it will come sooner.

Mr. STATON. Back to another question——

Mr. MITCHELL. Will the gentleman yield for a moment?

Mr. STATON. Yes.

Mr. MITCHELL. You told me September, that would be the out date——

Mr. Cardenas. On the 8(a); however, in my mind I was shooting for September on SBIC, but it is very possible we can do it sooner, and I will make every effort to do it sooner.

Mr. Staton. Back to a question on the size determination.

In your May 1 statement, you indicated that SBA had made size determinations for approximately 50 large SBA contractors. Have you completed that determination as yet?

Mr. Cardenas. No, it is in process.

Mr. Staton. When do you expect to complete that?

Mr. Cardenas. I would expect within the next 90 days we should have reports back on it.

Mr. Staton. Mr. Chairman, I have no further questions.

Mr. Mitchell. Mr. Smith?

Mr. Smith. Mr. Administrator, one effect of the program is shown by the success of those who have graduated from the program. In the case of the 8(a) program, this could probably be measured in terms of the number of Government contracts and volume of business done by the 166 firms which have graduated from the 8(a) program.

Has the SBA undertaken a study of this type, and do you think such a study would be useful?

Mr. Cardenas. I am not sure I understand your question.

Mr. Smith. Once the various businesses graduate from the program, has there be an ongoing study to determine whether they have made the transition into the open market?

Mr. Cardenas. No.

Mr. Smith. Should such a study as that be made?

Mr. Cardenas. Yes.

Mr. Mitchell. If the gentleman will yield.

As a result of some announcements from the SBA, Members of Congress have been receiving an awful lot of mail, I know I have and other Members have, on the 8(a) program. What I intend to do as I go through the mail, is to pull out a number of very good letters indicating that the firm was in the 8(a) program, it graduated or got out voluntarily and has gone on to achieve significant success.

I will be delighted to share that correspondence with the members of the committee.

Mr. Smith. That would be very helpful. Thank you, Mr. Chairman.

Mr. Mitchell. That did not come from your time, your 5 minutes.

Mr. Smith. Another question: It is my understanding that the GAO recommended that the 8(a) program be made into a two-tier program. Firms would first participate in the basic program for a fixed period of time, and then they would move into a second stage in which they would compete with other disadvantaged small businesses for Government contracts.

What does the SBA feel about that?

Mr. Cardenas. We have decided we want to evaluate all the implications of that two-tier program.

Mr. Smith. So it is under study now. Any idea how long before a determination is made?

Mr. Cardenas. Probably within the next 90 days.

Mr. Smith. One last question, Mr. Administrator. What portion of the firms in the 8(a) program have complete up-to-date financial information on file with the SBA? As I understand it, that has been a problem in the past, insufficient data collection.

Mr. Cardenas. I do not know. We do not have that information, Mr. Congressman.

Mr. Smith. Will you provide that to the committee for the record?

Mr. Cardenas. Yes. I do acknowledge there have been problems in that area.

[The information requested above follows:]

Approximately 52 percent of the 8(a) portfolio had submitted current financial statements as of fiscal year end Sept. 30, 1980. The business plan update is unknown without obtaining a complete review and count from all District offices. This has been monitored, however, by SBA's Field Management Division and is one of the key items of Public Law 96-481 to which attention will be given on an immediate basis.

Mr. Smith. I have had several meetings in my district with those who have applied and been denied, and also those who have been accepted in the program. If I can go back and tell them that yes, those who are in it are participating and have all their files up to date, they would feel much better. It might aid those trying to get into the program, if they fulfilled the letter of the law and were denied, that would give them a lever. We are mostly looking for a participation rate, whether those in the program are fulfilling the requirements of the law, because there are others who would like to be in the program who were promised they would and apparently are being denied.

Mr. Cardenas. That is correct; and as part of our future program, it is to keep a monitor so that all those in the program will be cooperating and working toward completion of their business plan and should work on that all the time they are in. It is not a matter of just being given *x* years to complete. They will have to work in that plan toward completion from day one. This will complete files for your information. We can go back and gather that information.

Mr. Smith. I also realize you have not been on the job all that long. So to have this completed would be difficult.

Mr. Mitchell. Congressman Crockett, you are recognized for 5 minutes.

Mr. Crockett. Mr. Administrator, I am one of the new members of the committee. I am just feeling my way. My questions and comments may not be quite as suave and diplomatic as those of some of my associates.

The big criticism I get everywhere I travel with respect to the Small Business Administration is various examples of what the people who complain tell me is evidence of racial discrimination, particularly with respect to black businesses. In my own district, Detroit, every time I go home, I have a delegation of small businessmen, for the most part, they are black, complaining about the difficulty of seeing and talking with any responsible people in the district office. At most they are shunted in to see some clerk or lower official and they are not even pleasantly received on those occasions. They are left with the distinct impression that this is the end of the line, "* * * if I tell you no, that is the end of it."

I would like to see this new Small Business Administration address that question and do something about it.

Second, I was reading, I think it was a couple of days ago, and I think it was in the Washington Post, the results of a study made of the so-called race riot in Miami about a year ago. The study pointed out one of the basic reasons for that disturbance was the discrimination visited by the SBA in making minority loans. In large measure, those loans are made to Cuban refugees who have come into the country and who are not citizens yet, and they apparently are being preferred over blacks who are citizens and long-time residents in the Miami area.

The article did give figures, which I do not have, but the figures indicated gross discrimination in favor of Cuban refugees.

Later, I will send a communication to you asking for a breakdown on what the actual figures show.

But I would like to hear your comment on both those points: the availability of your supervisory staff to talk with black small businessmen, and the extent, if any, to which noncitizens particularly in the Miami area have been preferred over citizens.

Mr. CARDENAS. With response to your first concern and question, I am very much aware of the situation via TV, newspapers, and letters. I can only say that I am deeply concerned about that, also, and I have always said that the program is for everyone, and that there should be fair treatment, and I shall certainly address myself to those questions.

On your second concern and question, I believe that possible discrimination, which I am not questioning, probably happened in the disaster program. The 8(a) program, they should be citizens, it is my understanding, to participate in the 8(a) program. The program that probably went on, involved disasters, was a disaster program, and that is another program which is making up a large part of our agency activities and which there is certainly much room for improvement. We are currently working on that right now. In fact, we had a hearing just recently. We are alluding to those problems, Congressman.

Mr. CROCKETT. Thank you, Mr. Chairman.

Mr. SMITH. Will the gentleman yield for a moment? I would be interested in seeing those facts and figures, too, because if it is the disaster loan account, it would seem the Cuban refugees, with the grave problems they face coming into this country, should be receiving those funds. I do not know if it has been discriminatory in its application. I would like to see that, and I would also like clarification as to whether they have to be citizens to receive 8(a) funds.

Mr. CARDENAS. It is my understanding, yes.

I am very sympathetic to your concern that there be equal treatment.

Mr. MITCHELL. Mr. Hiler?

Mr. HILER. Thank you, Mr. Chairman.

Hello again, today.

I would like to ask a question. You took office about 7 weeks ago.

Mr. CARDENAS. Correct.

Mr. HILER. I know you have been up here on the Hill for a number of hearings both on the House side and the other body.

Mr. CARDENAS. About three a week.

Mr. HILER. You have become aware of the many concerns Members have as to the functioning of the SBA. As you have had an opportunity to be immersed in the SBA and have had an opportunity to hear our reaction to the SBA, what kind of things go through your head when you go home and say "Gosh, what direction am I going to go?" What reactions have you had?

Mr. CARDENAS. Congressman, I have found there has been a letup in following policies and procedures that are set up and a good old business-type approach has not been carried on in the agency. I just started reviewing all programs and doing everything I can with staff at central office to see what we are going to do about it. There is much work needed in all programs. Let me state this, my optimism has not been shattered. I have devoted 8 years as an advisory council member on the west coast and I am proud to serve as the Administrator and continue what I call my community service on a national level.

I do not know whether I am answering your question directly, but I want to reiterate there is room for much improvement, and I am willing to work at it and make sure this agency continues as an independent agency and try to make it more effective in the future.

Mr. HILER. I think then in general you would agree with the proposition that what we have been doing in the past, whether in the 8(a) program or any other area of SBA, has not worked to the extent we would like to see it work, and in many respects may have been counterproductive. There may have been discrimination going on and there just needs to be a whole shakeup in attitude on getting the job done.

Mr. CARDENAS. That is true. I stress strongly that we should be advocates as individuals for the agency or we should not be there. The more time I spend in the office, the more I can see areas that need improvement. So, even though you keep me busy on the Hill, I am still committed to spend time in the office and take a personal view of all programs.

Mr. HILER. Hopefully after this round of hearings, we will give you some time to go out and do some producing. I hope you view these hearings as an opportunity for you to see what our concerns are. We are not here to blame you. In 7 weeks, you have not had a chance to get a handle on things.

When you took office one of the things you were concerned about was the 8(a) program and you said you were going to be undertaking a thorough review. I think you spoke yesterday that you were getting ready to put out regulations of some kind. What have been your general findings in your review?

Mr. CARDENAS. Well, the general findings have been that the spirit of the 8(a) program has not been allowed to work. Or it just has not worked. Too few have been allowed to participate and stay in the program too long. That was not the spirit of 8(a). The spirit of 8(a) was to give as many small, socially and economically disadvantaged firms as possible a chance to be included in the program. Our attitude has been to develop and implement the program so we would have an ongoing turnover. We found in the last few years, very few if any 8(a) contractors have been terminated or graduated.

I would like to refer to the program more as one of termination for inadequate carrying out of the purpose of the 8(a) program or completion, meaning the whole spirit of 8(a) should be to encourage more to get into the 8(a) program.

If we can develop this program to assure we are getting 200 to 300 coming in every year and 200 to 300 going out, I feel we are placing more into competition. That should create more jobs and at the same time bring in the one who has not had the opportunity to participate, to build up their business and create more jobs. That is why I see, in the end, if this program works properly, it can only mean more employment.

Mr. MITCHELL. If Congressman Savage will let me, I would like to make a statement before I call on him for questions.

I share your desire and those of the members of the committee to have as many as possible participate in the 8(a) program. That is desirable. I also feel we should have some system of two-tier approach or three- or four-tier approach. But I think at this point we should attempt to dispel the notions about the number of firms that receive the lion's share of 8(a) business. I think you said 2 percent of all the firms receive as much of 30 percent of the contracts, or figures roughly comparable to that. I do not quarrel with that statement or the GAO report, but I think we have to put that into context. I do not know how many members of the subcommittee are aware of the fact that the same 100 consultant firms during the time I have been in Congress have gotten 90 percent of all the Government contracts. I do not think that is right, yet I do not want to place these firms in isolation as if this were some particular error occurring in the 8(a) program.

Again by way of illustration, the distribution of 8 (a) contracts in the 8(a) program is far greater and more equitable than that among the prime contractors of the Department of Defense. The top 40 defense contractors, four-tenths of 1 percent received $40.9 billion in contracts for fiscal year 1980, or 53.3 percent of the total defense procurement.

On a percentage basis, then, five times as many 8(a) firms fared 22-percent less contract awards.

I just want to make it very clear that the problem that we are wrestling with is not one that is exclusively found in the 8(a) program. It is a problem that ought to be addressed across the board in Government, and I will have a little more to say about that a bit later on.

Mr. SMITH. Will the chairman yield?

Mr. MITCHELL. Yes.

Mr. SMITH. How many people are employed by the top defense contractors versus the small percentage of those receiving the 8(a) funding?

Mr. MITCHELL. Obviously it would be a small number.

Mr. SMITH. Do you have figures on that?

Mr. MITCHELL. No, I do not, but obviously—I think what we need to do is look at it on a racial basis.

Mr. SMITH. Boeing might employ hundreds of thousands of people and have a lot of feeder industries going into Boeing, as opposed to one small business contractor——

Mr. Mitchell. Let us say the contractors that I am talking about employ 300 people and look at their dollar volume. It cannot be done on a one-on-one basis. It has to be done on a proportional basis. Also I would indicate these firms that are getting the contracts are utilizing suppliers and others to add to the employment ranks. So I will try to get you some more accurate data on that.

Mr. Smith. Thank you for yielding.

Mr. Mitchell. Congressman Savage, you are recognized for 5 minutes for questions.

Mr. Savage. I represent a district in Chicago which is tops in the country in terms of minority business firms, and I do not agree with my colleague, Mr. Staton, at all.

From what I hear from those businesses, again, particularly black businesses, they can ill afford you to have another 6 months to continue as you have in the 6 or 7 weeks you have already been here. The reason is, you seem to have a lot of time to formulate new regulations and to verify programs and review programs and so forth, and in the process have suspended and slowed down some programs that are vital to the continued development of minority businesses who do not have the luxury of such time, who need the assistance of small business programs because they are not on any public payroll.

So, the question of having a moratorium on new 8(a) applications while you make sure that past mistakes are not repeated, why put the burden of that fault, if there is a fault, on these minority businesses?

Mr. Cardenas. Well taken, Mr. Savage. When I said a moratorium, we are keeping a very good track record of those who wish to apply, and certainly while we do go with regulations that may seem inflexible, certainly I am sensitive and I am going to evaluate as I go——

Mr. Savage. Do you realize one of the main problems with the 8(a) program in the viewpoint of minority businesses is that it was already taking too long a time from the time they applied to the time of certification. It was already too long, going too slowly, and you have come in, stopped it altogether. How can that be in the interest of small business, and particularly minority business?

Mr. Cardenas. Let me say first, there were 600 firms in the wings who had been certified who had never participated in the program. To comply with the law it is necessary that we give the opportunity to all those who want to participate. By doing this, there are many who never had the hopes of participating may have their hopes reinforced if they have the opportunity.

Mr. Savage. You have stopped some from applying. You have set a moratorium on accepting 8(a) applications.

Mr. Cardenas. On accepting, yes, but we will keep a list of all those coming in. [Laughter in audience.]

So what is the difference when we have 600 firms waiting who never had a job?

Mr. Savage. That means your problem was to speed up and not stop them. It seems to me you are going backward the same as the whole Reagan administration and confusing going backward with the change we voted for. We voted to speed things up.

Mr. Cardenas. I do not believe that is correct.

Mr. **Smith**. Will the gentleman yield.

Mr. **Savage**. No. I will finish my question.

Mr. **Mitchell**. If you yield to him, we will protect your additional time.

Mr. **Smith**. With respect to 600 firms that have been waiting, how long have they been waiting? Does it go back months or years?

Mr. **Cardenas**. Anywhere from 1 to 2 years.

Mr. **Smith**. Therefore, new applications being accepted today would not see the light of day for a long time. So, we are talking about a backlog of applications that date back to the Carter administration.

I believe what you are trying to do is come up with rules and regulations that will expeditiously deal with applications and eliminate the delays we have had in the past.

Mr. **Cardenas**. That is correct; I am trying to see that it is carried out in the true meaning of the law.

Mr. **Mitchell**. After assuming the chairmanship of this committee, I made a fervent plea that insofar as we could do so, that this committee operate on a nonpartisan basis. The problems of minorities and small businessmen are so great, that we ought not to allow partisanship to come into the picture.

I would ask that all my colleagues try to maintain a bipartisan posture.

Mr. Savage?

Mr. **Savage**. What my colleague Mr. Smith fails to understand is if the problem with the previous administration was delayed, with the present administration it is far worse because they have stopped it altogether. That is the problem.

Incidentally, you also have a moratorium on new licenses to SBIC, despite the fact that SBA has failed to solve the problem of the equity capital for minority firms, so again, you are going backward.

In the question of maturation, where you want to slow things down, try to determine how long a company need be in the program, are you thinking, even, in terms of 9, 10, to 20 years, as indicated by the SBA task force, in terms of the maturation period of companies, or are you thinking in terms of 3 or 4 years.

Mr. **Cardenas**. In terms of 3 to 5 years to give more opportunity to small businesspersons.

Mr. **Savage**. It happens I was a small businesman before coming to Congress. You may not understand the problems of a small business. If you think in terms of 3 to 5 years, banks do not even think in those terms. It takes that long to establish relationships with banks for short-term loans. And forget about access to the security markets. So even the terms in which you are thinking do not sufficiently recognize the needs of small business, and particularly minority businesses.

Mr. **Mitchell**. The gentleman's time has expired, but certainly you can respond.

Mr. **Cardenas**. First of all, I have had many years' experience as a CPA, and I have noted that, the greater percentage of failures have been in the first 5 years. I think the spirit of this program is assistance, not to carry them out throughout their careers. I do not think a period of 3 to 5 years in most cases is unreasonable, considering the fact we are bringing them into the mainstream on a noncompetitive basis. It is not as though they have been in business for 2 years and they are going out for competition. But we are bringing them in without competition, so you cannot compare Dun & Bradstreet statistics.

Again, I want to reiterate, this should be assistance, not a career program. Otherwise there is no way to assure 200 or 300 coming in or 2 or 3 going out.

Mr. SAVAGE. May I ask unanimous consent for 1 additional minute?

Mr. MITCHELL. If there are no objections, fine; 1 minute.

Mr. SAVAGE. I want to observe again the concept that the maturation period relates to the period of getting over the maximum danger of failure is the kind of backward thinking that bothers me about the Director of this Department.

We do not want to get a company to a point where it no longer fails; we want to get it to a point where it has a track record of growing and solid profits. I am bothered that you do not show more sensitivity and sympathy for small businesses and particularly minority businesses in view of your responsibility and authority.

Mr. MITCHELL. I am going to recognize Mr. Daub very briefly. I understand he has to leave.

Mr. DAUB. Thank you very much, Mr. Chairman.

Mr. Cardenas, it seems to me a number of us see you every day on the Hill, which demonstrates to me, at least, clear sensitivity to the wishes of Congress. I for one am grateful that you take a personal interest in being here, rather than sending some of your other employees in your Department to speak for you about programs which you will be administering for the next number of years.

I have a prepared statement, Mr. Chairman, I request, by unanimous consent, that it be placed in the record.

Mr. MITCHELL. Without objection, so ordered.

[Mr. Daub's prepared statement follows:]

PREPARED STATEMENT OF HON. HAL DAUB, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEBRASKA

Thank you, Mr. Chairman; I look forward to the testimony presented here today because it deals with a subject that a great many persons in my district have contacted me about.

I believe that our society has an obligation to facilitate the economic interests of those citizens who because of past discrimination do not have the requisite skills and background necessary to participate fully in our business sector.

I am concerned however by the apparent failure of the 8(a) program to accomplish what it was intended to do. It seems that very few firms participate, fewer graduate while a great number of minority enterprises appear to have no interest in the program. We are carefully scrutinizing those resources that are available to aid the disadvantaged. We ought to be certain that the funds expended in programs such as this are effectively used.

I am encouraged by the recent remarks of Mr. Cardenas that he and the SBA are seriously motivated towards making the program work and are unafraid to address it critically in order to correct its deficiencies.

Mr. Chairman, it has been my experience that the images attached to a number of government programs have done a great deal to undermine their effectiveness. If this program is viewed by people as a give-away wherein the government spoon feeds certain enterprises in order to meet certain quotas or goals then this program is a failure because that enterprise will not be taken seriously in the competitive, private world. It is my hope that Mr. Cardenas will undertake a thorough review of

8(a) with an emphasis on determining not just what the program is trying to do, but what it is in fact doing.

It is clear that there are a great many enterprises undertaken by members of disadvantaged groups that are today successful competitors demonstrating the strength of our system and its emphasis on individual merit as a determinate of success. The 8(a) program in concept could add to these enterprises and I encourage the SBA to examine the program and make the necessary changes and refinements so that it can emerge a healthier and more important asset for the people it is intended to help.

Mr. DAUB. Rather than reading it, I simply will indicate to you that I am encouraged by remarks that you made at other hearings, as well as those reported in the media, that you are seriously motivated to undertake an examination of 8(a) and that you will be unafraid to address it critically in order to correct its deficiencies.

I have 42,000 people who live in Nebraska's Second Congressional District who could be classified not only disadvantaged, but officially underprivileged. Many of those people happen to be black native Americans, Hispanics. In the lifetime of the 8(a) program, Mr. Chairman, we have only been able to certify 12 people.

One of those persons has been in it from the beginning and has been benefited to the extent of nearly $20 million worth of contracts. Others who have tried to get in cannot be certified. It just seems the program does need to be reevaluated. I think it is time to determine when people graduate, when they become viable, just how long assistance from the 8(a) program should continue.

But I want you to know that I fully support the intent of 8(a) and I commend you for your forthright commitment to preserving it and making it a viable and effective program, lest those detractors mount to eliminate it altogether if we do not address it from that point of view.

I have two questions, perhaps three.

I understand the SBA is considering setting limitations either based on time in the program or dollars awarded during participation. Will past time or past contracts be included in the new definitions that you intend to publish?

Mr. CARDENAS. Yes. As I said, every contracting firm will be evaluated on a case-by-case basis. We will work out and negotiate a business plan, in which case that is where the dollar volume will come in.

Mr. DAUB. Are you saying that past award and past number of years will be a part of the formula for defining viability in the future in the program?

Mr. CARDENAS. Yes.

Mr. DAUB. I appreciate that answer.

Have you considered in the area of goal attainment, the situation where a relatively large contract is awarded to one participant to satisfy a goal at the expense of involving greater numbers of contracts in terms of awards within the set-aside program? In other words, one Corps of Engineers project award is worth $4 million. It is set aside, and that satisfies the corps in percentages of attainment and it satisfies a percentage attainment in terms of the SBA set-aside award. But that will then count against some of these people if you are going to count previous contracts and previous years of service.

Mr. CARDENAS. It could. However, we are trying to get away from dollars. We do not want to be concerned with the overall dollar goal. We just want to do things that are fair within a negotiated business plan. I do not know if I have answered your question.

Mr. DAUB. I have a problem with that, Mr. Chairman, because I understand, for example, the Veterans' Administration, Corps of Engineers, and others, set percentages of dollars to be set aside in the awarding process. So, it seems to me, SBA has been forced into looking at dollars. If you can change that, I will support you, because I would like for you to start looking at the viability of a business.

But it seems you are forced now by the way contracts are set aside for negotiation, you are forced to look at dollar volume. I would like for you to examine that and resist as much as possible that situation.

Last question: Are you considering a proposal, for example, in paving contracting or window washing or security set-aside contracts of not only working hard to certify more than one disadvantaged business in 8(a), but to also develop a competitive bidding situation among those 8(a) certifieds, so that somebody's friend in some SBA office does not continue to hand out the contracts to just one business?

Mr. CARDENAS. Very definitely.

Mr. DAUB. So there will be competition among SBA firms for the set-aside contracts.

Mr. CARDENAS. We are considering that only to the extent we do not want any one firm to be bidded on an unfair basis.

Mr. DAUB. If you install competitive bidding among 8(a)s, you will find that the minority contractors that I work with will feel like the program is giving them a lot fairer shake.

Mr. MITCHELL. The gentleman's time has expired.

I would like to observe before you proceed to explore more deeply in that area, that you recognize that if you do so, it is in violation of law; Public Law 95-507 as it is presently written specifically prohibits that.

Mr. DAUB. I recognize that. I would like to see it as an idea to be submitted by them, if it is viable for us to consider. It is one of the areas where we might really save this program and make it do better and train disadvantaged men and women to do better once they graduate.

Mr. MITCHELL. Congressman Evans, you are recognized for your first 5 minutes.

Mr. EVANS. Thank you, Mr. Chairman.

I would first like to commend Mr. Cardenas for a very thoughtful statement. I would also like to commend the chairman for a very fair hearing on this matter and a very fair hearing on the whole question of 8(a) as a viable program.

I would first like to ask you, Mr. Cardenas, what will be the definition for a firm that is qualified to participate in 8(a), so far as size is concerned?

Mr. CARDENAS. On our current and usual size standards, which can vary from industry to industry, I would be glad to give you a report on that.

Mr. EVANS. The thrust of that is that you presently have 50 firms taking a substantial portion of the money. My concern about 8(a) is that not enough people have been able to be a part of the program. I have a number of minorities in my area who would like to participate and could be helped by the program, but when all the money is gone and I recognize you have a limited program, there is no way these people can participate. I do not object to the fact that you are taking a look at the program and that there is a moratorium, because I recognize you do have 600 firms who have been in the program qualified for a number of years and cannot participate. I also recognize there is a need above and beyond the small business program to assist minority businesses which do not qualify, and I would not be adverse to seeing such a program started, but I would not like to see it in small business because I think it is adverse to the very goals that we are trying to accomplish, which is to aid the small businessman.

So, there is no definitive answer that you can give me then as to who can qualify?

Mr. CARDENAS. It depends on the industry and the business. Again, I will reiterate that we need to look to every contracting firm on an individual basis. I am not picking on any specific type industry or any contractor. I am just interested in doing what I can to see that the 8(a) program continues in the spirit of the law as it was enacted, and I can only say I am committed to do everything I can to save the program.

Mr. EVANS. One of my criticisms of the program has been the inequitable distribution of funding in areas. For instance, there are eight States in the Southeast which have approximately 72,000 qualified small business disadvantaged businesses. In this region, there are approximately 42,000. The participants in the program in the Southeast has been 149 as compared to 507 in this region. The dollar amounts have been tremendously more in this area than they have been in the Southeast.

Will you take a look at what can be done to provide for a more equitable distribution in all regions of the country, because the needy in the Southeast and the West are just as needy as they are in the East or Midwest. I wonder if this is a part of the considerations you are looking at in trying to improve the program.

Mr. CARDENAS. Yes, sir.

Mr. EVANS. Let me understand, and this question may have already been asked. The people who have been in the program for a number of years and have received contracts amounting to $76 million in one case, $54 million in another case, tremendous contracts, contracts far above and beyond what is considered a small business to be, what will be the fate of these particular businesses under your administration?

Mr. CARDENAS. If they are considered to be large, they will be completed from the program. However, there are procedures for appeal to this and certainly they will be heard out.

Mr. EVANS. In the event all these firms appealed and you made a determination that most or all of them were no longer proper participants in the program, what do you anticipate being the length of appeal in termination of these people in the event you are successful?

Mr. CARDENAS. I envision up to 1 year.

Mr. EVANS. In order to prevent the temporary loss of jobs that our chairman has talked about, would it be feasible to talk about a phaseout over a year of these people who consent to graduate from the program rather than having us terminate those people?

Mr. CARDENAS. We would want to give every consideration to that factor, as long as it is legal.

Mr. MITCHELL. I am addressing a statement and question to you, Mr. Cardenas, and also Mr. Evans, I think you would be interested in my statement.

I am concerned about the number of firms which stay in the program for a long period of time. We have to do something about it. I am concerned about getting more in, but I do not think it is the fault of the firms that are in, or SBA's fault. The fault lays with the other agencies of Government. Every year, SBA goes to DOD and all agencies and requests they break out a part of their contracts for us.

The response of the agencies has at best been niggardly. They have refused to break out a number of contracts which would increase participation in the 8(a) program. I think that is one of the areas we have to address. I would hope, Mr. Cardenas, that you would pay strict attention to the agency recalcitrance we have had over the years. If indeed a fair break was given by DOD, Interior, or other agencies, there would be ample opportunity for others to participate. I simply urge you tackle that problem forthwith.

In addition, Congressman Evans, I like your idea of a phaseout, but I would like to take one caveat. I do not want to see a phaseout unless there is a movement of these firms into another quasi-market. I would like to see Mr. Cardenas get together with the Secretary of Commerce to see what can be done to move these larger firms into the mainstream. I say that simply because there is a wealth of voluminous information pointing out that even our top firms cannot compete with their white counterparts because of all the problems that exist with reference to access to capital.

Mr. EVANS. Will the gentleman yield?

Mr. MITCHELL. Be delighted to yield.

Mr. EVANS. In addition to all the bad bills I introduced in connection with this program, I think the chairman might be able to support a bill which would help accomplish what the chairman is trying to address in the many agencies which have refused to do what they should have been doing in allowing small businesses including minority small businesses to participate by taking issue with the SBA statement that they can award these contracts to small businesses.

As you know, under the present process, they go through an appellate process in which SBA has to appeal.

The record of those appeals has been about 20 percent successful because the people making the judgment are the heads of the agencies which are refusing to let SBA award these to small businesses.

Now, I think if we could get that bill through, then I think SBA can make the determination and have a period of time in which those contracts can be awarded or could be bid on by small businesses. If they get a successful bid, that would be a determination, and there would be no appeal.

Mr. MITCHELL. Let me just say the idea intrigues me, but in light of your bad bills, I want to study this.

Mr. Evans. Mr. Chairman, for 13 years I have been in public service. During those 13 years, I have devoted a great deal of my time to bringing minorities into full partnership in the political process. I have the record to prove that.

Now, down home, you get stubborn mules sometimes and the only way you get their attention is to hit them in the head with a 2 by 4. The bills I have introduced are literally and figuratively a 2 by 4 to try to get more widespread participation of minorities in the SBA program. That was my desire as I discussed with you before, and I think we are moving somewhat in that direction at the present time with some caveats.

Mr. Mitchell. If the gentleman will let me reclaim my time, I used your phraseology and did it facetiously. There is strong resistance in breaking down contracts. Again, Mr. Evans, if there is a $35 million contract, obviously only a large firm will be able to do that contract. I have implored the agencies for years to break their contracts down into smaller components so more can have access to them. That is the second part of the problem I wish you would address.

I know I am over my 5 minutes. Just let me get in a couple more questions, if I may.

I am concerned about your 3- to 5-year time period because you are saying that is all that is necessary for graduation from 8(a). I do not want to see SBA accused of prejudging. It may appear that is what is happening.

For 2 years, this Small Business Committee and the Congress rejected the idea of a fixed number of years for 8(a) firm participation. Now you have come to the public with a 3- to 5-year figure. What data did you use to arrive at that 3- to 5-year period?

Mr. Cardenas. I used what I called a good common business sense approach——

Mr. Mitchell. If I may interrupt you for a moment. You are our guests at this hearing, and we will not permit audience participation.

You may proceed, Mr. Cardenas.

Mr. Cardenas. I am not that insensitive that I would not listen and take certain factors into consideration. We are getting ready to publish in the Federal Register and we will have time to consider the extension of time requested. But in my years of public accounting experience, I have yet to see where one businessman or firm that was at least given 1 year of assistance and help, did not appreciate it. In the spirit of the 8(a) program, I do not think, with the exception of very minor situations, that they would extend beyond that period.

Mr. Mitchell. Again, I am really trying to be protective of you. I do not want the SBA to be accused of prejudging, particularly in light of the fact your SBA venture capital study repudiates the direction in which you are going, and also the study done by Georgia Tech repudiates the 3- to 5-year approach. Might I suggest that you take another look at those studies, and there might be some give and take?

Mr. Cardenas. I am sure if I had asked each of the contractors in the program I would have gotten a long range of answers based on their desires.

Mr. MITCHELL. I am not concerned with their desires, but what is hard and real as to data.

Mr. CARDENAS. The fact they are on a noncompetitive basis and they are at an advantage——

Mr. MITCHELL. By reemphasizing that you are not closing the door to further consideration, are you?

Mr. CARDENAS. No, sir.

Mr. MITCHELL. Mr. Hiler?

Mr. HILER. I guess I would have only one comment relating to the time frame. I think it very important that someone trying to make a program work more effectively than it has in the past must look at the problems.

We have heard this morning, people have been staying too long. Having a time frame in mind is not a negative thing, and I think you have illustrated that you intend to manage the SBA with a degree of flexibility as well. So I, personally, think you are moving in the right direction.

I have no further questions.

Mr. MITCHELL. Mr. Evans, you are now again recognized. We are reduced in number, so we do not have to adhere to the 5-minute rule. Why not take 10.

Mr. EVANS. I certainly support your reevaluation of this program, in view of the fact that over the 12-year history of this program we have had four basically unfavorable GAO reports. This 8(a) program has been the subject of one or two or more congressional hearings.

I would like to further explore the bills I introduced as being in frustration for past administration failures to take into consideration these critical reports, not in an effort to terminate the program, but in an effort to address those problems which exist which are keeping money from a great number of minority small businesses which have not been able to participate. All my efforts are in that vein, that I want the people in my area, the people in the West, the East, and the Midwest, to be able to participate in the program.

When you have, as you have had in this program, some 4,200 firms that have been certified, you have had 2,400 or more drop out of the program, you have had 600 which have been certified, that have not been able to participate, and you have had approximately 180, which I question, that have so-called graduated from the program.

Has there been any analysis by the SBA as to what has happened to those businesses that have graduated from the program?

Mr. CARDENAS. No; there has not.

Mr. EVANS. I suspect some of those businesses are no longer viable businesses, which makes the record of 8(a) even less successful than it appears. Then you are talking about less than 5 percent graduation.

I would like to agree with the chairman, maybe to his surprise, that maybe a 3- to 5-year time is not enough to deal with trying to make a company an economically viable competitive company in the private sector. I do not think the 15 years is necessary or 10 years in dealing with most companies. There may be examples when a certain company needs to go beyond, but certainly a couple more years would be a more reasonable figure as to some participation in the program.

I have talked to you about the regional distribution. One other problem I have been upset about is the number of minority front firms. I do not think this program was intended to benefit wealthy majority entrepreneurs and I think that has happened in more instances than it should. I wonder what you or your people are planning to do about eliminating the so-called minority front firms?

Mr. **CARDENAS**. Congressman, we will be addressing that problem very fervently.

Mr. **MITCHELL**. Will the gentleman yield at that point?

Mr. **EVANS**. Certainly.

Mr. **MITCHELL**. That has been of some concern to me, too. I think the figures bandied around are unreal. I can only relate my personal experience with EDA last year where we did a tight monitoring of the program. On a weekly basis, I got a report, and no more than 5 percent front firms were discovered in that whole public works program.

I have an amendment drafted which I think will take care of that problem. I am waiting for the proper vehicle to put it on. The amendment provides for 10 years in prison, a $50,000 fine, or both. As soon as I find the proper piece of legislation on which to attach it. I think with that kind of severe punishment pending, you will see a diminishing of front companies.

Mr. **EVANS**. I laud you in that amendment, and I will support you in that amendment. But I have had the experience of majority people contacting me about the possibility of getting 8(a) money by setting up a front. I have told them I was opposed to it and would not do it.

Mr. Chairman, I think I have covered most of the problem areas very superficially, but I would just like to again urge Mr. Cardenas to try to come up with those safeguards in this program which would accomplish the goal of Congress, which is certainly a laudable one, and very frankly, Mr. Chairman, we may not be talking about nearly enough money to do what we are trying to do here, but certainly we need to make the money go as far as we can in assisting the greatest number of people who have need of assistance. If we have a need for large firms to get assistance, then we need to do that under another agency and not under Small Business.

Mr. **MITCHELL**. Will the gentleman yield?

Mr. **EVANS**. Yes.

Mr. **MITCHELL**. I would like to enlist your support in helping me to further develop a draft for some action through Commerce which would deal with these larger firms that are graduating. I am delighted to hear you say you see the need for that kind of vehicle, and I publicly enlist your support.

Mr. **EVANS**. I am not blind; I know what has happened in this country over the past 200 years, and I know of the need for minorities to participate in the political system in this country. Certainly I will support your amendment, and I laud the chairman for his efforts.

Mr. **Mitchell**. Is it not true, Mr. Cardenas, that nonminorities also participate in the program?

Mr. **Cardenas**. Yes, absolutely. I want to correct that image so everyone is aware of that.

Mr. **Mitchell**. It is important to do that publicly. Many of the attacks against this program are based on misperceptions that it is solely and exclusively for minorities.

What is the dollar value of contracts which have gone to nonminorities?

Mr. **Cardenas**. I do not have figures ready, but I will be glad to submit them.

[The information referred to above follows:]

Since the inception of the program (1968) to January 31, 1981, there were 645 contracts awarded to 282 firms for $112,353,118.

Mr. **Mitchell**. Would my ball park figures be fairly accurate, that maybe since the inception you have had 118 firms earn to the tune of $109 million plus in contracts?

Mr. **Cardenas**. Probably in the ball park.

I thought I had figures on that——

Mr. **Evans**. Mr. Chairman, will you yield?

Mr. **Mitchell**. I will.

Mr. **Evans**. I might add, I am not one of those who had the mistaken impression that 8(a) just dealt with minorities. I am aware of what the program does, and I took that under consideration.

Mr. **Mitchell**. Let me assure the gentleman this was in no way directed toward you.

Mr. Smith?

Mr. **Smith**. No questions.

Mr. **Mitchell**. It is a difficult spot you are in. You are trying to preserve and protect a program and at the same time make some fundamental changes. You are changing policies. With whom do you consult in terms of the policies that you are recommending? Is it with the White House, or do you consult with the private sector or persons in the private sector? Do you consult with the other agencies?

Mr. **Cardenas**. I have talked to some members of the other agencies. By the way, getting back to the agency, I will proceed to open up a door of communications and let them know what we are doing in trying to increase our volume in contracts.

I consult with my staff, some people in industry, I take into account reports by GAO and other reports which have been and possibly have not been completed or printed, but internal reports prepared by staff with wide participation, from the transition team reports, and just try to take a rounded view of things.

Mr. **Mitchell**. What about the private sector?

Mr. **Cardenas**. Yes; during my years as a member on the advisory council, I can recall much input at the advisory level——

Mr. **Mitchell**. Since you have formulated these policies you have not consulted with anyone in the private sector?

Mr. **Cardenas**. No.

Mr. **Mitchell**. Can you specify the agencies within Government you did have communications with?

Mr. CARDENAS. Maybe not the administrators, but I have talked to representatives of the Army and Navy. They were very general conversations. As a matter of fact, I was telling staff to arrange meetings and to start contacting other agencies next week so we could open up good communications with them. I want to make sure we have open doors of communication to expand this program.

Mr. MITCHELL. Certainly you have the authority to have those kinds of consultations, and I think they are good. In our system of democracy I think it is good even though you have authority as a head of agency, it is good to consult, just as Mr. Reagan consults with business and labor leaders.

Before framing these policies, did you consult with representatives from the minority business community?

Mr. CARDENAS. No.

Mr. MITCHELL. Why not?

Mr. CARDENAS. It would take a long time to get input from everybody we should. They will have an opportunity upon publication in the Federal Register to submit. If I had opened the door to one contractor——

Mr. MITCHELL. That would have been a dangerous thing to do, talk to one contractor. But there are a number of trade associations; maybe you could have had dialog with them.

Mr. CARDENAS. Certainly that will be carried on during the period this is being published.

Mr. SMITH. Mr. Chairman——

Mr. MITCHELL. Be delighted to yield.

Mr. SMITH. In one of our earlier hearings when many of the associations came in and made presentations as to their agenda, some of those goals were listed. I wonder if the SBA read the record or consulted the record regarding that.

Mr. CARDENAS. Yes; staff did. Prior to my Senate confirmation I had the opportunity and did go out of my way to visit as many people on the Hill—this was certainly a topic of much concern. There was a lot of input from the constituencies via the Congressmen and Senators.

Mr. MITCHELL. You consulted with members of this subcommittee?

Mr. CARDENAS. No, they were courtesy visits prior to my confirmation.

Mr. SMITH. What I thought was a fine feature of this was that we heard testimony on the overall agenda, and since that was part of the record, I thought it behooved the SBA to consult it.

Mr. MITCHELL. We intend to continue that practice. There will be another informal meeting where we can get a feel from the small business community. Most of the members of the committee agreed that was a helpful approach.

One of the problems I have as a legislator is making sure I do not exceed my own legal authority. Members of Congress have a great deal of latitude in what they can do.

Simply by way of illustration, I put out a newsletter. In my newsletter, I pointed out that a minority business library had been named in my honor. Well, I was rapped on the knuckles for that. That was exceeding my authority. You cannot do that in a newsletter. I just did not know. Sometimes we do those things without attempting to be in violation of the law.

What concerns me is, you went ahead and proposed actions to halt the 8(a) action by June 1. You are changing that now and imposed a moratorium on new applicants entering the program. Did your agency's legal counsel, did you consult with him on the propriety of that?

Mr. **Cardenas.** Yes.

Mr. **Mitchell.** If so, what are the legal authorities to support your action? Can you tell me what counsel indicated as being your legal authority to do this?

Mr. **Cardenas.** Staff members in the legal department indicated I was not in violation of any legal act.

Mr. **Mitchell.** That was your first response, but what I am trying to get to is, on what legal authorities did they base that advice?

Mr. **Cardenas.** That will have to be submitted for the record.

[The information requested above follows:]

Authority to impose the May 1, 1981, moratorium on new applicants entering the 8(a) program is found in the broad authority given him by the Small Business Act (see sections 4, 5, and 7(j)(10), which permits the Administrator to manage the Agency).

Mr. **Mitchell.** It will be appreciated because, again, that is a matter of simply trying to protect you in this new job as you move forward to strengthen this agency.

Some several moments ago, this subcommittee requested some detailed information regarding the volume of 8(a) contracts, their relationship to the total Federal procurement process, the relationship of 8(a) commercial business per company, et cetera.

We have not received that information. It was a request made and I would like to know where that information has been gathered, analyzed or factored into your policies for minority business development programs. Has there been such an analysis made?

Mr. **Cardenas.** Yes, sir. That was probably sent to you under separate cover.

Mr. **Mitchell.** I recall I received a preliminary statement indicating you were working on it, but not a final document.

Mr. **Cardenas.** I am referring to your letter dated April 21, 1981.

Mr. **Mitchell.** That is right. I have a copy of my original document and your response but, as I indicated, I think, you did not submit a complete response. I will again sit down with you. I would like to get that in as quickly as possible because I do not believe you can pursue the implementation of new policies until such time as you have done that analysis.

Mr. Evans?

Mr. **Evans.** Mr. Cardenas, it was my understanding that proposed changes and policies, the new regulations, were being formulated and would be completed sometime this week. That may be erroneous on my part. I wonder if we could have made available to the members of this committee the policies that are being proposed so that we might have the opportunity to analyze those, and I would like to ask further in hearing the questions this morning, and I am particularly interested in the problems that I see in the program, if those problems have been addressed by the new proposals?

Mr. CARDENAS. They certainly are directed in that direction to correct the problems and to do everything possible to eliminate potential abuses. The regulations can be made available to you. They are being reviewed by OMB now and I will be glad to make copies available to you.

Mr. EVANS. Do you recall any particular problems we talked about this morning that were not addressed in the new regulations and if Mr. Templeman has a comment I would be glad to hear from him.

Mr. TEMPLEMAN. The policy changes we made are in the standard operating procedures attached to Mr. Cardenas' statement.

Mr. EVANS. Particularly the problem with inequitable distribution regions. Is there anything in particular in the new proposals which addresses that problem, or is this supposed to be a general result of the tightening up of the program in certain areas?

Mr. CARDENAS. That is correct. It is not addressed to me per se but it is my responsibility to see that department is functioning as required.

Mr. EVANS. You do recognize there has been an inequity in the distribution of funds?

Mr. CARDENAS. Yes.

Mr. MITCHELL. During testimony before this committee, the Administrator indicated he was working on more specific standards, and came back with a proposal presented before this committee to try to deal with size standards. The members of this committee rejected that proposal, saying go back and take another look. SBA agreed to come back to give us a second look at some proposed new size standards.

Are you aware of those proceedings and that we are waiting on new size standards?

[Mr. Cardenas submitted the following proposed rule:]

SMALL BUSINESS ADMINISTRATION

13 CFR Part 124

MINORITY SMALL BUSINESS AND CAPITAL OWNERSHIP DEVELOPMENT ASSISTANCE

Agency: Small Business Administration.

Action: Proposed rule.

Summary: The proposed amendment to the current regulations of the Minority Small Business and Capital Ownership Development Assistance program will implement those provisions of Public Law 96-481 (October 21, 1980), which require SBA to establish a fixed period of time for every participant concern to remain in the program.

Date: Comments should be received no later than 60 calendar days from publication of this notice in the Federal Register.

Addresses: Interested parties may submit comments on these proposed regulations to the Office of General Law, Small Business Administration, 1441 L Street, N.W., Washington, D.C. 20416.

For Further Information Contact: Charlie L. Dean, Chief Counsel for Special Programs (202) 653-6699.

Supplementary Information: Particular areas covered in the proposed amendment include:

1. Section 124.1-1(f)(1) makes clear that the newly authorized Fixed Program Participation Term is a limited period for program participation in addition to and not as a substitution for periods of program participation limited by Completion actions pursuant to subsection (d) of the regulations or Termination actions pursu-

ant to subsection (e) of the regulations. This provision also specifies that this newly authorized Fixed Program Participation Term is a requirement for program eligibility.

2. Sections 124.1-1(f)(2) and (f)(3) specify that the Fixed Program Participation Term shall be negotiated between SBA and the participant concern and shall be set forth in the concern's business plan. This provision also establishes time limitations for concerns currently in the program to submit a Fixed Program Participation Term for negotiation with SBA.

3. Section 124.1-1(f)(4) establishes maximum periods of time for Fixed Program Participation Terms and provides for a one-time extension of such term. This provision also provides a preliminary Fixed Program Participation Term for concerns currently in the program pending negotiation of a regular Fixed Program Participation Term.

4. Section 124.1-1(f)(5) sets forth the criteria and policies which SBA will apply in negotiating Fixed Program Participation Terms for new program applicants and for concerns currently in the program applying for the necessary revision of their business plans.

5. Section 124.1-1(f)(6) provides that no Section 8(a) contracts may be awarded to a concern unless it has a Fixed Program Participation Term approved by SBA.

6. Section 124.1-1(f)(7) makes clear that the cessation of program eligibility at the conclusion of a Fixed Program Participation Term shall, in essence, be automatic, requiring no additional action by SBA and giving rise to no additional rights for the concerns. It is also emphasized that the cessation of program eligibility at the conclusion of a Fixed Program Participation Term is not subject to the Administrative Procedure Act hearing requirements of Section 8(a)(9) of the Small Business Act.

7. In establishing Fixed Program Participation Terms, the proposed regulations differentiate between concerns initially applying for program eligibility and concerns currently in the program, applying for a revision of their business plans to incorporate the required fixed terms.

For the purpose of Executive Order 12291, effective February 17, 1981, SBA hereby determines that these proposed rules, if finalized, would not constitute major rules. In addition, it is hereby certified that, for the purposes of the applicability of the requirements of sections 603 and 604 of the Regulatory Flexibility Act (Public Law 96-354, September 19, 1980, 5 U.S.C. 603 and 604), these proposed rules will not, if promulgated, have a significant economic impact on a substantial number of small entities. These rules govern only those firms which have been or will be admitted to participate in SBA's section 8(a) program. This number is not substantial relative to all small business firms in the United States.

Dated: May 27, 1981.

MICHAEL CARDENAS, *Administrator.*

Therefore, pursuant to the authority of Section 5(b)(6) of the Small Business Act (15 U.S.C. 634(b)(6)), the Small Business Administration proposes to amend Part 124 of its Regulations (13 C.F.R. Part 124) by adding a new Section 124. 1-1(f) to read as follows:

(f) *Fixed program participation term.*—(1) In addition to Program Completion and Program Termination, set forth in subsections (d) and (e) of this section, every program participant shall be subject to a Fixed Program Participation Term. A Fixed Program Participation Term will establish the ultimate time period during which a concern may remain in the program and the conditions thereof, regardless of whether competitiveness is reached or Program Completion action is effected.

Except as noted in this section, a concern may not be accepted or continue in the program without a Fixed Program Participation Term.

(2) This Fixed Program Participation Term shall be negotiated between SBA and each small concern which is a participant or has applied for participation in the program.

(3) The provisions of the Fixed Program Participation Term, including the time limitations therefor, shall be set forth in the SBA approved business plan of the program participant.

(i) A concern currently in the program shall submit to SBA a proposed revision of its business plan, incorporating a Fixed Program Participation Term, within two months from the effective date of this section 124.1-1(f). This Fixed Program Participation Term must be established, following negotiations pursuant to subsection (f)(2) no later than April 21, 1982.

In negotiating this revised business plan, SBA will determine whether the concern currently in the program should be terminated, pursuant to subsection (e) of this section, completed pursuant to subsection (d) of this section, or extended subject to a Fixed Program Participation Term. A determination at this time, however, to extend a concern subject to a Fixed Program Participation Term shall not preclude SBA from initiating Program Completion action or Program Termination action at any time prior to the completion of the Fixed Program Participation Term.

(4) The maximum Fixed Program Participation Terms shall be as follows. These maximum terms shall apply both to concerns applying for entry into the program and to concerns currently in the program, applying for a revision of their business plan to incorporate a Fixed Program Participation Term as required by these regulations.

For concerns whose primary business activity is classified by SBA as "service" ——— three years.

For concerns whose primary business activity is classified by SBA as "construction" ——— five years.

For concerns whose primary business activity is classified by SBA as "manufacturing" ——— five years.

For concerns whose primary business activity is classified by SBA in any other category ——— five years.

(i) Not less than one year prior to the expiration of the Fixed Program Participation Term, a concern may request SBA to review and extend the difference between the Fixed Program Participation Term established in the business plan and the maximum Fixed Program Participation Term authorized herein, plus one year. There may be no further extensions.

(ii) For concerns currently in the program applying for a revision of their business plan to incorporate a Fixed Program Participation Term, SBA may, at its option, accept these revisions upon receipt for the purpose of a preliminary Fixed Program Participation Term not to exceed one year, pending negotiation of a regular Fixed Program Participation Term as set forth herein.

(5) The criteria that SBA will use in negotiating a Fixed Program Participation Term or an extension thereof with current program participants and applicant program participants are as follows:

(i) The factors referenced in section 124.1-1(c)(4) of this regulation for determining economic disadvantage.

(ii) The number and dollar amount, and the progressively decreasing importance, of section 8(a) contract support that it is anticipated will be necessary to achieve competitiveness. In order to maximize limited program resources, SBA will emphasize business plans anticipating lesser amounts of section 8(a) contract support to reach competitiveness.

In negotiating a Fixed Program Participation Term for concerns currently in the program, SBA will consider the section 8(a) contract support previously received by the concern. An SBA determination that such previous contract support has failed to appreciably contribute toward a timely achivement of competitiveness will be a significant factor toward limiting the Fixed Program Participation Term and the conditions thereof.

(iii) The number and dollar amount and the progressively increasing importance of contract support, other than section 8(a) contract support, that it is anticipated will be necessary to achieve competitiveness. SBA will emphasize business plans having greater reliance on this non-section 8(a) contract support to reach competitiveness.

In negotiating a Fixed Program Participation Term for concerns currently participating in the program, SBA will consider the non-section 8(a) contract support previously received by the firm. An SBA determination that the concern has failed to progressively increase the importance of such non-section 8(a) contract support will be a significant factor toward limiting the Fixed Program Participation Term and the conditions thereof.

(iv) The length of time that it is anticipated will be necessary to achieve competitiveness. In order to maximize limited program resources, SBA will emphasize program participation for those concerns closer to competitiveness.

In negotiating a Fixed Program Participation Term for concerns currently in the program, SBA will consider the length of time during which the concern has previously participated in the program. The degree to which the past participation in the program has exceeded the maximum Fixed Program Participation Terms set forth in subsection (f)(4) herein, will be a factor toward limiting the Fixed Program Participation Term and the conditions thereof.

(v) The degree to which it is anticipated that Advance Payments and Business Development Expense will be necessary to enable the concern to successfully complete section 8(a) contracts and the extent to which reliance upon such proceeds will progressively decrease in importance. In order to maximize limited SBA resources and to increase exposure to regular competitive procedures, SBA will emphasize maximum use of conventional governmental and private resources in performing such contracts.

In negotiating a Fixed Program Participation Term for concerns currently in the program, SBA will consider the previous Advance Payments and Business Development Expense received by the concern. An SBA determination that such Advance Payments and Business Development Expense support has failed to progressively decrease in importance during its previous participation in the program will be a factor toward limiting the Fixed Program Participation Term and the conditions thereof.

(vi) The rate at which it is anticipated that a concern will decrease its reliance upon all forms of program support, especially section 8(a) contract support, in reaching competitiveness at the end of the Fixed Program Participation Term.

In negotiating a Fixed Program Participation Term for concerns currently in the program, SBA will consider the previous rate at which the concern has decreased its reliance upon program support and correspondingly increased its reliance upon conventional governmental and private contract business. An SBA determination that the concern has failed to appreciably improve its rate of business reliance in this manner will be a factor toward limiting the Fixed Program Participation Term and the conditions thereof.

(6) No contracts pursuant to 8(a) of the Small Business Act shall be awarded to any concern unless it has received and is operating under an SBA approved Fixed Program Participation Term.

(7) Nothing in this subsection (f) shall be construed to limit SBA from initiating Termination actions, pursuant to subsection (e) above, or Completion actions, pursuant to subsection (d) above, during any Fixed Program Participation Term granted herein.

(8) Upon the conclusion of the Fixed Program Participation Term granted and/or extended herein, a concern will cease to be a program participant. This cessation of program participation shall occur without the necessity of any additional action by SBA; also it shall not give rise to any rights, claims or prerogatives on behalf of the concern. Cessation of program participation at the conclusion of the Fixed Program Participation Term shall not be subject to the hearings or other requirements of Section 8(a)(9) of the Small Business Act (15 U.S.C. 637(a)(9)) or any implementing rules or regulations.

SMALL BUSINESS ADMINISTRATION

(13 CFR Part 124)

MINORITY SMALL BUSINESS AND CAPITAL OWNERSHIP DEVELOPMENT ASSISTANCE

Agency: Small Business Administration.

Action: Interim Rule.

Summary: Public Law 96-481 (October 21, 1980) requires SBA to negotiate with every Section 8(a) concern a fixed period of time ("Fixed Program Participation Term") for the concern to remain in the Minority Small Business and Capital Ownership Development Program. Among the other provisions of that statute is the prohibition against the award of Section 8(a) contracts after June 1, 1981, to any concern which does not have an SBA approved Fixed Program Participation Term. In order to implement this statute, SBA has published elsewhere in this Federal Register a Notice of Proposed Rulemaking (proposed 13 C.F.R § 124.1-1(f)). As can be seen, the effective date of these proposed regulations, when adopted in final form, will be after June 1, 1981, the date after which the statute prohibits the award of Section 8(a) contracts to a concern which does not have an SBA approved Fixed Program Participation Term. Accordingly, in order to avoid disruption in the operations of Section 8(a) concerns if the limitations of the June 1, 1981, date are imposed, this interim regulation authorizes temporary Fixed Program Participation Terms for concerns beginning June 1, 1981.

This interim rule is effective upon publication due to the noted exigency of the situation. This regulation and any Fixed Program Participation Terms authorized hereunder will expire on November 30, 1981. Before that date, it is anticipated that the permanent Fixed Program Participation Term regulations, referenced above, will have been adopted in final form and that regular Fixed Program Participation Terms will be negotiated pursuant thereto.

For the purpose of Executive Order 12291, effective February 17, 1981, SBA hereby determines that this rule would not constitute a major rule. In addition, it is hereby certified that, for the purposes of the applicability of the requirements of sections 603 and 604 of the Regulatory Flexibility Act (P.L. 96-354, September 19, 1980, 5 U.S.C. 603 and 604), this rule will not have a significant economic impact on a substantial number of small entities. This rule governs only those firms which have been or will be admitted to participate in SBA's Section 8(a) program. This number is not substantial relative to all small business firms in the United States.

Dates: This interim rule is effective upon publication in the Federal Register.

Address: For further information contact: Charlie L. Dean, Chief Counsel for Special Programs, telephone 202/653-6699.

Dated: May 27, 1981.

MICHAEL CARDENAS, *Administrator.*

Therefore, pursuant to the authority of § 5(b)(6) of the Small Business Act (15 U.S.C. § 634(b)(6)), the Small Business Administration hereby amends Part 124 of its regulations (13 C.F.R. Part 124) by adding a new § 124.1-1(g) to read as follows:

(g) *Fixed program participation term.*— (1) In addition to Program Completion and Program Termination, set forth in subsections (d) and (e) of this section, every program participant shall be subject to a Fixed Program Participation Term. A Fixed Program Participation Term will establish the ultimate time period during which a concern may remain in the program and the conditions thereof, regardless of whether competitiveness is reached or Program Completion action is effected.

(2) The purpose of this interim rule is to provide for temporary Fixed Program Participation Terms pending adoption of permanent Small Business Administration regulations (proposed 13 C.F.R. § 124.1-1(f)) setting forth the detailed policies and procedures for establishing regular Fixed Program Participation Terms. A temporary Fixed Program Participation Term, authorized pursuant to this rule, shall not extend beyond November 30, 1981.

(3) This Fixed Program Participation Term shall be negotiated between SBA and each small concern which is a participant or has applied for participation in the program.

(4) The provisions of the Fixed Program Participation Term, including the time limitations therefor, shall be set forth in the SBA approved business plan of the program participant.

(5) No contracts pursuant to 8(a) of the Small Business Act shall be awarded to any concern unless it has received and is operating under an SBA approved Fixed Program Participation Term.

(6) Nothing in this subsection (g) shall be construed to limit SBA from initiating Termination actions, pursuant to subsection (e) above, or Completion actions, pursuant to subsection (d) above, during any Fixed Program Participation Term granted herein.

(7) At the end of the temporary Fixed Program Participation Term authorized herein, a concern will cease to be a program participant unless it has received a Fixed Program Participation Term under the applicable permanent regulations (proposed 13 C.F.R. § 124.1-1(f)). This cessation of program participation shall occur without the necessity of any additional action by SBA; also it shall not give rise to any rights, claims or prerogatives on behalf of the concern. Cessation of program participation at the conclusion of a Fixed Program Participation Term shall not be subject to the hearings or other requirements of Section 8(a)(9) of the Small Business Act (15 U.S.C. § 637(a) (9)) or any implementing rules or regulations.

(8) This regulation and any temporary Fixed Program Participation Terms in effect thereunder shall expire on November 30, 1981.

Mr. MITCHELL. Let me explain why I wanted to stress this point: I think if you threaten to arbitrarily remove certain firms from the SBA program you are dealing with several contradictions. The size standard has not been revised since 1975. I think they are out of date, particularly when a firm is judged on average sales over a 3-year period. Over a year ago, SBA proposed to use the single measure of size of total number of employees ranging from 15 to 2,500, depending upon the industry involved.

You, yourself have admitted, I think, to the inadequacy of size standards.

In the Washington Post earlier this year you were quoted as testifying before the Senate Select Small Business Committee:

> The size rules are a mish-mash developed over the years which reflect the ad hoc bureaucratic method of dealing with problems as they come up.

Obviously then, there is an enormous necessity for you to come before this committee and this Congress with a specific program on size standards if one could be devised which would eliminate this mish-mash effort.

Mr. **Cardenas**. That is true, and we are going to publish for public comment very soon additional changes based on review and analysis of size standards.

The Senate Small Business Committee just had a hearing recently. On the other hand, we do not know how long this will take.

Mr. **Mitchell**. It is a tough one.

Mr. **Cardenas**. It is a tough one and it could take a good long while to satisfy those requirements. I do not think it is in the best interest of Government to wait, to try to save the program.

Mr. **Mitchell**. I am certainly not going to quarrel with you on that, that is a prudent action to take, but also bearing in mind, because you are using size standards to move some firms out of a program, it is awfully important that some decent size standards be developed.

We have been here 2 hours; let me try to summarize some of my understanding of your testimony. You have been most cooperative and we appreciate your appearance.

It is my impression that your proposed June 1 graduation of some firms is not going to be delayed approximately until September. Is that correct?

Mr. **Templeman**. There was never any proposal to graduate firms on a given date. The box that we go in, if you will, is the regulations to preclude terminating of contract support.

Mr. **Mitchell**. The regulations vis-a-vis contracts, that will be deferred until September; is that correct?

Mr. **Templeman**. Yes.

Mr. **Mitchell**. I want to be very clear that you will consider extending the time for comment, beyond the 30-day period. I really think that is inadequate and I would hope you would so do.

With reference to the moratorium on 8(a) firms, am I correct in recalling that you indicated two things: One, that in certain meritorious cases where they were in mind, you have gone ahead and acted on those pending applications?

Mr. **Cardenas**. SBIC——

Mr. **Mitchell**. But not on 8(a).

Let me talk about 8(a), because it is critical there too to allow for flexibility. You get a guy working for 5 months getting contracts lined up and the contractor says fine, you got it as soon as you are certified. I think it is arbitrary and almost capricious to impose a moratorium with no flexibility, and I would hope you would allow flexibility, and I would also hope the moratorium on the 8(a) certification will not last beyond September.

Mr. **Cardenas**. Let me clarify, those in process we will continue to take a look at them. I am not trying to be insensitive or inflexible.

Mr. **Mitchell**. A couple more things in summarizing: As I understand it, you anticipate lifting the moratorium on SBIC's hopefully by September?

Mr. **Cardenas**. That will be my attempt.

Mr. **Mitchell**. On the action that was proposed for June 1, which you are now deferring; have you advised all the agencies of the Government of that deferral?

Mr. **Cardenas.** We will be doing that next week. I hope to meet them on a personal basis to explain that.

Mr. **Mitchell.** I would urge you do that immediately to clear up the confusion in the agencies in Government. We have situations where some of the agencies are anxious to give the contract but they feel they cannot touch it until SBA makes the determination. So if you will inform the agencies in writing, it might help clear up the confusion.

Mr. **Cardenas.** Just as soon as OMB gives clearance on that we will proceed. It should be this week or possibly the next week.

I will also talk with our regional administrators to make sure they have a clear understanding so they are not proceeding with information that may be creating a problem.

Mr. **Mitchell.** I do not understand; you have to get clearance from OMB to advise the other agencies?

Mr. **Cardenas.** No, as to regulations. Let me put it this way, I will still consult with them on a personal basis, we will contact them by phone, give a brief explanation, set up an appointment, and if they are willing, I will be willing to meet with them Monday, even if it is a holiday.

Mr. **Mitchell.** What happens if OMB says, "No; we do not like them?"

Mr. **Cardenas.** They will not say no, but I will pursue it even further.

Mr. **Mitchell.** They will not say no?

Mr. **Templeman.** It is a bureaucratic routine of approval, but we have to go through it.

Mr. **Mitchell.** These are strange times and there have been all kinds of deviations from procedures.

Thank you very much for your participation.

Mr. **Cardenas.** Thank you, Mr. Chairman and members of the committee.

[Additional material supplied by Mr. Cardenas for the hearing record follows:]

U.S. Small Business Administration,
Office of the Administrator,
Washington, D.C., June 17, 1981.

Hon. Parren J. Mitchell,
Chairman, Committee on Small Business, House of Representatives, Washington, D.C.

Dear Mr. Chairman: Thank you very much for your letters of May 28 and 29, 1981, concerning additional questions Members of the Committee have regarding recent changes in our 8(a) program.

Enclosed are our responses to the twenty-three questions. I am pleased that the Members of the Committee are as concerned for the success of this program as we are. I am confident that with time we will all begin to see positive actions taking place.

Your continued interest and support of the Small Business Administration are appreciated and if we may be of further assistance please let us know.

Sincerely,

Michael Cardenas, *Administrator.*

Enclosures.

Question 1. By regulation, authority for advance payment approval is delegated to the Regional Administrators. You have alerted this without following the Administrative Procedure Act requirements for regulatory change. Do you plan to correct this apparent violation?

Answer. Authority for advance payment approval is still delegated to Regional Administrators with limitations of 40 percent or $100,000 whichever amount may be less. These limitations of authority do not preclude recommendations from the Regional Administrators to the Central Office for justifiable larger amounts. Field offices and central office personnel working together in instances which exceed the threshold amount we believe to be a program safeguard. Additionally, the use of an advance payment on more than one subcontract by a client must be approved by the central office. This action was imposed to prevent abuses and to ensure careful accounting and control of repayment schedules.

We are cognizant of the regulatory changes required by the imposition of this new management control and have submitted to the Office of Management and Budget a request for approval to have the current regulation changed in the Code of Federal Regulation.

Question 2. SBA has historically taken the position that a firm can in certain instances outgrow its original size standard while in the 8(a) program and still be eligible for 8(a) assistance. How does your change insure compliance with the business development objective of Public Law 95-507?

Answer. Prior to the enactment of Public Law 95-507 the 8(a) program was managed by administrative interpretations without specific congressional direction. With the passage of P.L. 95-507 a more detailed direction was imposed. Public Law 95-507 clearly specifies that business concerns that are eligible socially and economically disadvantaged firms shall be "small." The SBA business development program will be provided to eligible small disadvantaged firms pursuant to the law. Once a small disadvantaged firm has exceeded a size standard through the 8(a) business development program the company will then pass from the purview of the program. This does not preclude an appeal with the administrative law judge under section 8(a)(9) of the Small Business Act.

Question 3. How do you define your Agency's "advocacy" role in the area of "minority business development?"

Answer. The Small Business Administration through its advocacy office and its individual program bureaus is the advocate for all small business including small minority companies participating in the 8(a) business development program. Our role also includes working with the Department of Commerce to assist and advise in matters pertaining to minority businesses not in the 8(a) program and companies in excess of our size standards.

Question 4. What method does SBA use to collect and store data on 8(a) and non-8(a) minority businesses? Is the procurement for the SBA data base proceeding on the schedule presented to the Committee in February 1981? Can we be assured that all contracts will be signed by May 30, 1981?

Answer.

a. The 8(a) Financial Information System (8(a) FIS) was designed to record financial information pertaining to advance payments and business development expense provided to 8(a) companies. A major effort is now underway to expand all aspects of a company's business plan, support provided, performance record, financial and management progress, etc. The magnitude of this effort will encompass several months. The target date for completion is December 31, 1981.

Non 8(a) minority as well as 8(a) approved companies are included in the Procurement Automated Source System (PASS) which is a computerized listing of firms used as a referral source for prime and subcontracting opportunities.

b. The procurement for the SBA data base for small socially and economically disadvantaged companies is proceeding on schedule and as heretofore reported is scheduled for completion on line by December 31, 1981. The General Services Administration accumulates procurement data semi-annually from all civilian agencies. We understand all civilian agencies have not yet reported, and therefore GSA has been unable to publish a report for the first six month period of fiscal year 1981. The Department of Defense publishes procurement data quarterly, at this time SBA has access to military procurements only. Consequently, it is impossible to report the complete accumulations of procurements data as of this date.

c. All procurement offerings matched to an 8(a) approved firm and negotiated to conclusion by May 31, 1981, will be signed. Those that were not completely negotiated and therefore not signed by that date will continue to conclusion and signature as soon as the 8(a) client has accepted and executed the temporary program participation term pursuant to the interim rule as published in the Federal Register June 1, 1981.

Question 5. Have you published final regulations defining social disadvantage? If yes, please provide this Committee with copies. If no, when do you intend to issue such regulations? Will they differ from the interim rule defining social disadvantages published by SBA in December, 1980? If so, please provide the specific differences.

Answer. Final regulations defining social disadvantage have been prepared in draft form and differ slightly from the two interim rules published in the Federal Register on December 1, 1980. The new regulations are being reviewed and considered by the Office of General Counsel and should be ready for final publication in the near future.

Question 6.

a. I would be interested to know how you reconcile your new policies with the statutory mandate and authority given the AA/MSB. For example, what is your authority for assigning to your office (via the districts and regions) responsibility for contract selection for contracts $2 million or over? How was this amount arrived at? Did you consult with either the Acting AA or the AA designee prior to making announcements about this policy?

b. Why did you provide yourself alone the authority to waive regulations governing the MSB program when prior authority was given to the AA/MSB as part of his mandate from Congress to manage the program, develop and implement policy, etc.?

Answer.

a. The selection of contracts of $2,000,000 was not assigned to the Administrator. The Regional Administrator is responsible for the receipt of procurement offerings and the company matching process. The action taken was to review these selections necessitated by GAO reports that indicated excessive awards to a few and the absence of any awards to many companies. As reported in my testimony before the Small Business Committee, this action permitted more careful management of procurement offerings and equitable distribution of offerings among portfolio companies.

My action does not conflict with the mandate and authority of the AA/MSB as Public Law 96-481 specifically states that the section 8(a) "shall be managed by the Associate Administrator for Minority Small Business and Capital Ownership Development under the supervision of, and responsible to, the Administrator."

Most contract opportunities are considerably less than $2,000,000. Procurement offerings in the amount of $2,000,000 and more had historically been awarded to a few companies where procuring agencies generally had established a favorable quality and product/service acceptance rate. The amount was set to ensure a careful inspection of opportunity for other potential deserving companies.

The announcement was made May 1, 1981. The AA/MSB was appointed May 8, 1981. The Acting AA/MSB and the AA designee were consulted with regard to the desirability of implementing this management tool.

b. Public Law 96-481 clearly sets forth that sections 7(j) and 8(a) "shall be managed by the Associate Administrator for Minority Small Business and Capital Ownership Development under the supervision of, and responsible to, the Administrator." Regulation cannot be waived but the Administrator may waive standard operating procedures based upon the recommendations of program officials.

Question 7. In the area of SBICs and MESBICs, what is your position on the use of public funds for leveraging? In view of the GAO opinion will SBA agree to leverage the HUD public funds provided to MESBICs?

Answer. A fundamental concept of the SBIC/MESBIC program is that of having truly "private investment" at risk prior to the investment of SBA leveraged funds. Sound business principles are applied to a private market investment transactions as a result of this concept. Likewise this investor exposure to risk of investment loss acts as an automatic regulatory control feature helping to reduce SBA's regulatory oversight burden with respect to SBICs and MESBICs.

To allow recognition of Federal funds as "private capital" undermines the basic principal of the program, destroys the inherent private market test associated therewith and, in so doing, removes an essential element of accountability necessary to proper operation of the program.

SBA will publish shortly in the Federal Register a proposed regulation barring leverage on public funds unless expressly required by Federal statute. This proposed regulation reflects the GAO decision of July 29, 1980.

However, in light of the equities involved, and in view of the GAO opinion of January 30, 1981, regarding MESBIC leveraging of Community Development Block Grant (CDBG) funds, SBA has determined to "grandfather in" and provide leverage on those CDBG funds which were part of MESBIC private capital prior to the proposed regulation noted above.

Question 8. What is the number and dollar amount of 8(a) contracts returned by SBA to agencies in fiscal years 1979 and 1980?

Answer. SBA does not maintain a record of procurement offerings returned to agencies, and therefore cannot report such returns for fiscal years 1979 and 1980.

Question 9. What is the number and dollar amount of bond waivers approved by SBA pursuant to the 8(a) Pilot Bond Waiver Program?

Answer. The SBA field offices have successfully obtained outside bonding for most companies that have applied for participation in the 8(a) Bond Waiver Program. As a result thereof, the central office to date has received no bond waiver requests pursuant to Public Law 95-507.

Question 10. The last time you were before this Committee I brought to your attention the problems many minority business persons were encountering due to a shortage of personnel in the Philadelphia Regional Office. At that time you indicated you would give these problems your attention. Please provide me with specific examples of how you have resolved these problems.

Answer. The problems of limited personnel resources in the Philadelphia Region are recognized and under current management review and analysis. Current budgetary constraints and personnel hiring restrictions prevent any immediate hiring of additional personnel. The alternative is to study a realignment of personnel at the regional and central office levels to determine whether reassignments can be made. We plan that changes will be made for partial alleviation of the shortage in Region III, but we have not yet completed our review. We anticipate this may be accomplished within the next 60 days. To temporarily alleviate this situation, this week approximately eight professionals have been detailed to Region III to assist the 8(a) program.

Question 11. Is there a freeze on processing new direct loans? If so, when do you anticipate your field offices will begin processing new applications?

Answer. There is no freeze on processing new direct loans under our regular loan program. For several years now, the demand for direct loans has far exceeded the availability of funds needed to satisfy that demand. Chronological waiting lists have been established in each office. Most have waiting lists of up to two years for these scarce funds. Applications are processed each quarter as additional funds become available.

Question 12. What specific assistance is provided by SBA to assist firms in marketing their services? Also, has SBA discontinued its practice of requiring potential 8(a) applicants to secure contract commitment letters from other agencies?

Answer. A number of marketing sources are utilized and include:

1. Direct introduction to appropriate federal procuring activities.
2. The introduction of minority companies to Federal prime contractors seeking minority subcontractors.
3. Referral to Minority Business Development Agency for expansion of opportunity in the public and private sector.
4. Staff personnel visitations to major Federal and non-Federal prime contractors to promote minority company capabilities.
5. The PASS referral opportunity.
6. Field and central office personnel participate in Congressional and corporate workshops and procurement fairs.
7. Publication and distribution of potential 8(a) source list to major corporations and subcontracting publications identifying the small business company representative in all major Federal prime contractors and their divisions in the country.
8. Individual counseling with 8(a) personnel, PCR's, subcontract specialists and management assistance officers.

SBA rules and regulations and standard operating procedures never instituted the practice of requiring 8(a) program applicants to secure contract commitment letters from a procuring activity. Initially when applications for 8(a) program participation were received a determination was made as to potential availability of support. Frequently potential procurement offerings were not yet submitted to SBA by the procuring activity and were therefore unknown to SBA. Applicants already familiar with government marketing who knew about a forthcoming procurement would request the buying agency to prepare a letter that would show evidence of procurement support if the firm was approved for the 8(a) program.

Question 13. The recent General Accounting Office report "The SBA 8(a) Procurement Program—A Promise Unfulfilled" (CED 81-55) on the 8(a) program made a number of recommendations and criticisms of the way in which the program has been administered.

A. Please provide your analysis of the following criticisms. To what extent do these problems exist and how severely do they effect program operations.

What is being done to correct these deficiencies?

Answer. Because of insufficient staff the program is poorly monitored. (Page 6.)

Prior to the passage of Public Law 95-507, field and Central Office staff were confined to Procurement Assistance and never had more than approximately 100 professional employees nationally. Subsequent to Public Law 95-507 the 8(a) staff was included within Minority Small Business and Capital Ownership Development which then permitted the merger of additional persons not yet familiar with or trained in the many requirements of the 8(a) program. A new organization was formulated to provide monitoring of the program and company compliance with rules and regulations and procedures. During the past several years the field staff was primarily concerned with achieving dollar goals and there was a lesser emphasis in monitoring the client companies. Public Law 96-481 redirects a greater emphasis in monitoring staff functions and requirements are being considered at this time.

There is a lack of specific and objective criteria for determining the business development status of program participants. (Page 6.)

SBA agrees with GAO that specific and objective criteria were lacking. However, the passage of Public Law 96-481 and subsequent proposed new rules and regulations, which will be implemented in SOP revision, will assist in a better determination of the business development status of program participants.

SBA has assigned a low priority to business development. (Page 6.)

From the program inception in 1968, SBA established as its goal the business development of a few manufacturing companies. As pressures mounted to include additional categories of businesses such as construction companies and related types and various professional service and non-professional service type companies, the portfolio grew rapidly and forced decentralization of program operation and management to field offices in 1971. Personnel acquisition was unable to keep pace with the accelerated demands of the program. Expansion of numbers of companies approved for program participation only on the basis of social or economic eligibility without regard for the ability to support companies as called for in Public Law 95-507, was the accepted practice at that time period. With the pressures of mandated program dollar goals, the program moved from the traditional business development aspects of the program. As previously stated Public Law 96-481 corrects this direction of the program.

Poor management by SBA results in 8(a) firms being helped unevenly. (Page 10.)

Prior program management as previously expressed was reduced to expanding contract awards. Business development and monitoring was sacrificed to the task of requirement acquisition in order to achieve mandated goals which resulted in an uneven distribution of program assistance. As previously testified to in my statement of May 21, 1981, there were approximately 620 companies who received no awards while 50 companies received 31 percent of all contract dollar awards since program inception.

Many disadvantaged firms have been denied the chance to participate because SBA has not taken graduation or termination action on 8(a) firms who should not be in the program. (Page 31.)

There is no question that portfolio admittance was denied to companies because program completion was not managed effectively. It is for this reason SBA intends to limit program participation as expressed in the Federal Register June 1, 1981. Firms will be carefully reviewed and a fixed participation term will be established to cause movement of some from the portfolio annually and provide opportunity for others seeking opportunity. As I testified on May 21, 1981, in order to provide proper 8(a) program opportunity to thousands of deserving eligible small disadvantaged firms, there must be a reasonable procedure for eligible small firms to enter the program, receive a prudent level of contract support and other assistance, and exit the program at an appropriate point in time. It must be understood that exit from the program will not always be successful completion. SBA can provide opportunity and assistance—ultimately present and future success of any business firm depends on itself.

Business Development Specialists cannot assess the progress of many 8(a) firms because significant information is missing. Firms commonly submit incomplete financial data and business plans. (Pages 32-33.)

The GAO and SBA's IG reports identified this area of concern and pointed clearly to the fact that field personnel did not follow SBA's own standard operating procedures and did not enforce company compliance. However, SSA intends to take the remedial steps necessary to force compliance with its standard operating procedures with failure to comply forcing company expulsion from further program participation.

Small, rather than big, businesses have borne the burden of supporting the 8(a) program. SBA has neglected its policy assessing the potential impact on small businesses. (Page 52.)

SBA established impact procedures in its first program standard operating procedures and continuouly emphasized these procedures with each subsequent publication. More analysis of potential impact and greater impact studies of requirement offerings must occur as a protection to all small business. SBA in forthcoming standard operating procedures will emphasize the need and delineate the method to be used by field personnel in this endeavor. SBA will manage field review and will monitor and emphasize the implementation of this direction.

Question 13B. How do you plan to respond to the following recommendations: Take action to fill BDS vacancies. (Page 38.)

Currently SBA's management personnel is reassessing the personnel needs as related to the workload. Every effort will be made to provide adequate personnel as budgetary constraints will permit. As reported in testimony to the Small Business Committee on May 21, 1981, personnel realignments will occur where reassignments can be made as personnel may become available. It should be noted that as of this date the SBA, as other agencies, is still under a personnel freeze.

Provide BDSs with adequate training, especially in understanding financial statements. (Page 38.)

SBA supports the need for adequate training of personnel and has identified to its field offices training opportunities. Courses available with the military services and in General Services Administration regions will be pursued along with public education opportunity. In the future, training will be more specialized to the program needs which will include financial statements, procurement methods, and contract administration.

Direct participating 8(a) firms to submit accurate business plan projects and financial statements. (Page 38.)

Public Law 95-507 and Public Law 96-481 clearly establish these elements for primary monitoring and evaluation of company progress towards completion or termination. Rules and Regulations and standard operating procedures require annual review and updating of business plans as well as quarterly financial statements. Failure to comply will be cause for company program termination. This has been a requirement of the program standard operating procedure but has not been enforced in the past. We have directed that this requirement will be met in the future.

Provide standardized criteria for determining adverse impact on other small businesses. (Page 53.)

As previously stated, impact criteria and methodology have been established. Emphasis on compliance will be stressed with program personnel.

Require full implementation of the adverse impact policy. (Page 53.)

The standard operating procedures heretofore in effect as well as any new publications will stress implementation. Field Management Division personnel will include this impact problem as a subject of review when inspecting program compliance at SBA field offices.

Question 14A. How many of the 2,183 firms now active in the 8(a) program have complete and up-to-date financial statements and business plans on file with SBA?

Answer. Approximately 52 percent of the 8(a) portfolio had submitted current financial statements as of fiscal year end September 30, 1980. The business plan update is unknown without obtaining a complete review and count from all District Offices. This has been monitored, however, by SBA's Field Management Division and is one of the key items of Public Law 96-481 to which attention will be given on an immediate basis.

Question 14B. By when do you expect to have complete data in your files on each 8(a) participant?

Answer. The requirement of Public Law 96-481 mandates compliance by April 1982 establishing negotiations for fixed program participation. Annual reviews are an immediate requirement SBA intends to address. Once all data is obtained, SBA's on-line computers will provide information readily at each field office and in the central office where adequacy of compliance can be readily monitored. We estimate this will be completed on or before the second quarter of fiscal year 1982.

Question 15. The quality of management assistance provided by SBA to 8(a) firms has been widely criticized. In light of this, do you feel that SBA is capable of providing effective management assistance? If so, how do you plan to improve the assistance you offer to 8(a) firms?

Answer. Public Law 95-507 in section 7(j)(10) provided for a program of assistance which SBA is using to the extent of its funding. It is SBA's intent to complete its requirements of management assistance to the maximum extent of competent capability to provide assistance vital to the 8(a) program clientele. Assessment of clientele needs and requirements will begin in fiscal year 1982 to improve the delivery of management assistance to meet the specific requirements of 8(a) participants.

Question 16. A 1975 work standards study done by SBA determined that the ideal caseload for Business Development Specialists is approximately 8-10 firms. GAO found that as of September 30, 1980, each BDS had a caseload of 17 cases.

Answer. The national 8(a) program portfolio comprises 2173 companies. The regional breakdown of current participants in the 8(a) portfolio is:

Region	Companies	BDS number	Ratio
I	97	13	7-1
II	172	9	19-1
III	557	16	35-1
IV	180	10	18-1
V	211	15	14-1
VI	249	5	50-1
VII	85	7	12-1
VIII	132	6	22-1
IX	325	6	54-1
X	165	5	33-1
Total	2,173	92	24-1

It should be noted that the 1975 study was a theoretical analysis of the ideal case workload as envisioned at that time. At no time since program inception has the program workload ever attained that highly favorable relationship. With passage of Public Law 95-507 and in particular Public Law 96-481, the program direction has once again changed. As previously stated, an assessment of central and field office personnel needs is being made by management.

Question 16B. What do you plan to do to reduce the caseload and to enable BDSs to perform their functions more completely?

Answer. SBA envisions that the portfolio will remain about the same size. Compliance with Public Law 95-507, and more specifically Public Law 96-481, should effect an annual turnover of approximately 300 firms from the portfolio by virtue of the assignment of fixed participation dates for program completion. This quantity will undoubtedly be replaced by a like number of applicants. While the portfolio size and caseload will remain the same approximate number, SBA intends to insist upon more stringent compliance with the direction of Public Law 96-481, the new rules and regulations and standard operating procedures. Efforts will be made to provide a more equitable distribution of contract support within the entire portfolio thus reducing contract brokering to a few and enhancing business development. The effect of these actions will be a reappraisal of the role of the BDS in relationship with the clients.

Question 16C. What training do you plan to offer to Business Development Specialists this year?

Answer. In addition to the training previously discussed in paragraph 13B, plans have been formulated to hold separate training for central office professional staff, the Assistant Regional Administrators for MSB-COD and field professional staff of the regional/district offices. This training will focus on the requirements of Public Law 95-507, Public Law 96-481, new rules and regulations and standard operating procedures.

Question 17. GAO recently issued a report criticizing the 8(a) pilot program ("The 8(a) Program for Disadvantaged Small Business Has Not Been Effective" (CED 81-221)). What is your reaction to its findings and what do you plan to do to implement its recommendations.

Answer. The 8(a) pilot program was included as a part of Public Law 95-507 to establish a new procedure to obtain procurements of high technology and longer production runs which would stabilize assistance to the more sophisticated companies of the 8(a) portfolio. SBA admits that the report is accurate in the fact that the program is not as effective as had been anticipated. The requirement selection and matching process was in some instances inappropriate and prevented timely delivery. SBA admits that extreme care and compliance with more specific standard operating procedure furnishing better guidance to its personnel is a prerequisite if the pilot program is to be a success. Better liaison with offering agencies and assistance from the more technical staff personnel is important to this pilot program endeavor. The recommendations noted by the GAO report have been considered and many adopted.

Question 18. Your May 1 press release (#81-22) identified serious problems in the following areas:

Lack of program termination or completion.

Answer. Fundamentally the General Accounting Office and SBA's own review teams noted that there has been virtually no program completions and/or terminations since 1975. During this same time frame the preponderance of contract dollars have gone to a select group of 50 firms, while approximately 600 firms have received no assistance. It should also be noted that during this period a number of these firms have apparently become large business and have been the recipients of SBA regional prime contractor of the year awards and aerospace prime contractors subcontractor of the year awards.

The lack of program completions and/or terminations has essentially fixed the size of the portfolio and has precluded assistance to current eligible firms and the admittance of many others.

Question 19. Pages 12 and 13 of your written testimony discuss problems you have found in the Small Business Investment Company program. Please explain more specifically the nature of the problems you discovered.

Answer. The SBA Inspector General's "Report on a Special Survey of the Small Business Investment Company Program" surveyed a three year history of SBIC regulatory examination findings and concluded that there were several areas in the program where action could be taken to prevent abuse. These areas are listed below together with actions undertaken or under consideration by the Agency.

1. Capital Manipulation—The IG found a number of cases in which the required initial unrestricted private capital was not in fact available due to undisclosed encumbrances or restrictions.

SBA has implemented a new standard bank confirmation form regarding unrestricted private capital. In addition, we will require that all 10 percent or more stockholders of an SBIC document the sources and status of their capital contributions and submit financial statements to SBA. The Agency also has under consideration the elimination of automatic first tier leverage for 301(d) SBICs, which has been the major cause of so-called capital manipulations.

2. Sanctions—The IG concluded that presently available sanctions for regulatory violations should be more effectively utilized.

SBA currently has under study both currently available sanctions as well as potential new enforcement actions designed to improve the SBIC regulatory environment. In addition, SBA has in process a comprehensive review of the SBIC regulations which is intended to streamline the regulatory process and make it more efficient.

3. Procedural—The IG concluded that several types of internal organizational and procedural changes could improve the regulatory process.

SBA has revised its examination letter procedure giving the IG an opportunity for concurrence prior to transmittal of those letters to the SBICs. SBA has also initiated a new pre-licensing review procedure by which the affected SBA District Office is responsible for evaluation of (a) the character and reputation of the proposed SBIC's principals and (b) the need and necessity for the SBIC.

4. IG Examinations—The IG found that a more effective use of the SBIC examiners could be made if SBIC examinations were required every two years.

SBA has supported a legislative change to extend the SBIC examination requirement to a two year cycle, allowing concentration of resources on more audit depth in problem-area cases.

In addition, SBA is developing a uniform reporting system for counting violations of SBIC regulations.

Question 20. On page 19 of your statement you indicated that some SBA positions may be transferred from the central office to field offices. What types of positions do you feel are most critically needed in your field and regional offices?

Answer. The caseload and requirements of Public Law 96-481 clearly point out a need for trained business development specialists.

Question 21. A recent article in the Washington Post indicated that "unless the SBA comes up with an interim solution, it may be forced to shut down its billion-dollar Minority Contracting Program in two weeks—an act that could spell financial disaster for firms that depend on it."

Answer. Rules and Regulations were published in the Federal Register on June 1, 1981, which precluded a shut down of the 8(a) program.

Question 22. The General Accounting Office has recently issued a report on the 8(a) pilot program. What will you do to implement its recommendations?

Answer. SBA believes that total compliance with its Pilot Program operating procedures will effect implementation of GAO's recommendations.

Question 23. To what degree do minority contractors utilize the various management training programs available to them, such as the Small Business Development Centers?

Answer. There have been 50,216 minority attendees to training programs and 21,285 instances of minority counseling sessions. During fiscal year 1981, training of 4,582 minority concerns has occurred with 1,605 counseling sessions by Small Business Development Centers.

[Whereupon at 11:40 p.m., the subcommittee adjourned, to reconvene subject to call of the Chair.]

SMALL BUSINESS ADMINISTRATION'S 8(a) PROGRAM

THURSDAY, JUNE 4, 1981

HOUSE OF REPRESENTATIVES, SUBCOMMITTEE ON SBA AND SBIC AUTHORITY, MINORITY ENTERPRISE AND GENERAL SMALL BUSINESS PROBLEMS, COMMITTEE ON SMALL BUSINESS,

Washington, D. C.

The subcommittee met, pursuant to notice at 10 a.m., in room 2359-A, Rayburn House Office Building, Hon. Parren J. Mitchell (chairman of the subcommittee) presiding.

OPENING STATEMENT OF CHAIRMAN MITCHELL

Mr. MITCHELL. The subcommittee will come to order.

Today is the second of three hearings on the Small Business Administration's 8(a) program, a program designed to facilitate the development and expansion of socially and economically disadvantaged businesses into the economic fabric of this Nation.

To achieve this objective, the 8(a) program is designed to provide socially and economically disadvantaged firms with procurement, management, and technical assistance.

On May 21, 1981, this subcommittee launched its first review of the 8(a) program. Mr. Michael Cardenas, Administrator, U.S. Small Business Administration, presented the Administration's position on the future direction of this vital minority business program. This first hearing focused on several major areas of concern:

Graduation dates for 8(a) firms as required by Public Law 96-481;

8(a) contract continuation passed June 1, 1981 [this date was established in Public Law 96-481 as the last date for SBA to finalize graduation dates for 8(a) firms];

Fiscal year 1981 goals for minority businesses;

Termination or program completion for 8(a) firms alleged to be above SBA's size standards;

A phaseout program for 8(a) firms which are eligible for 8(a) graduation;

The Administration's public announcement of its commitment to minority businesses.

These are the things that we focused on at the last hearing.

Moratorium on the admission of new 8(a) firms;

Improvement of SBA's 8(a) contract delivery system;

Management and technical training for SBA's 8(a) personnel; and

The Administration's position on pending legislation to terminate the 8(a) program.

Mr. Cardenas in his testimony assured this subcommittee of the Administration's strong support for the 8(a) program and its opposition to legislation which would terminate the program.

Mr. Cardenas also announced the Administration's intention to not allow the 8(a) program to come to a halt on June 1, 1981, as a result of the Administration's failure to implement timely graduation requirements pursuant to Public Law 96-481.

In this regard, SBA published in the June 2 issue of the Federal Register proposed graduation regulations and interim regulations which will allow agencies to continue contract negotiations with 8(a) firms past June 1, 1981. Mr. Cardenas agreed to remain open to review data which supports a longer 8(a) program participation than the 3-5 year period suggested or proposed by SBA.

Finally, Mr. Cardenas projected an early September date for the lifting of the moratorium on the admission of new 8(a) firms.

Let me digress just a moment. I learned late yesterday afternoon that there appears to be an effort on the part of the SBA to go ahead with graduation of some firms despite the commitment made to this committee.

We will check that out today, and I can assure the general public that we are not going to countenance any person coming before a committee of the Congress making commitments and then proceeding administratively to break those commitments.

We will check that information out today and we will act promptly on it if indeed there is some effort to avoid the commitment that was made to the Congress through this subcommittee.

The 8(a) program was administratively established in 1968 under the Nixon administration. Indeed, in the early years of the program, the Administration's efforts to assist minority businesses were feeble at best. Inadequate operating procedures, subjective administrative guidelines, questionable status of certain minority companies and open hostility from procuring activities were but a few of the many problems of the 8(a) program.

In 1978 I was successful in generating open enthusiasm from my colleagues in the passage of legislation which would remove many of these administrative and procedure inefficiencies from the program.

Public Law 95-507 represented the first time in the contemporary history of this Nation that this legislative body endorsed legislation for a strong minority business development program and to correct prior 8(a) management problems.

Since 1978, the 8(a) program has served as one of the few procurement avenues available to minority businesses. I firmly believe that this Congress and this Nation must become committed to strengthening this program. Indeed, if the 8(a) program is allowed to drift by the wayside, this Congress and the Nation will have reneged on its commitment to reduce the social and economic racism which has prohibited minority businesses from full participation in the minority enterprise system.

Of course, there are some opponents of the 8(a) program who do not believe that the Federal Government has a responsibility to assist minority businesses. Indeed, they cloud their opposition to the program by alleging waste, fraud, and abuse.

I have publicly stated that the 8(a) program is in need of being strengthened. Mismanagement and other violations cannot be tolerated. However, the only sensible course of action is to improve the quality of the 8(a) program.

Again, I digress from my written statement, and I would want to submit this to the record. I am citing an article from the Washington Post dated April 8, 1981.

The caption is, "General Accounting Office cites mismanagement in Defense consulting work."

We will go through that article to see whether or not indeed there is waste and mismanagement in the Department of Defense. If there is, and I suspect that there is, I have not heard anyone suggesting dismantling the Department of Defense.

Returning to my original statement——

Mr. Gonzalez. You better look out. They are liable to contract it out.

Mr. Mitchell. I would have no objections if it is contracted out to minority firms.

Today, this subcommittee will continue its examination of the 8(a) program. This hearing will focus on the Administration's implementation of "tough new 8(a) program policies" and pending legislation to terminate this program.

I am deeply concerned that the Administration in its zeal to respond to public criticism of the 8(a) program has in fact implemented a course of action which may be plagued with administrative as well as legal irregularities.

Moreover, I am becoming alarmed with the impact of the Administration's new policies on 8(a) business program.

In this subcommittee's effort to develop a more complete scenario on the direction of the Administration in implementing the 8(a) program, we have invited 8(a) business owners as well as professionals who work on a daily basis with 8(a) businesses to testify.

I am also delighted to have Congressman Gonzalez with us and later Congressman Billy Lee Evans will join us.

Mr. Gonzalez. Will the chairman yield?

Mr. Mitchell. I yield.

Mr. Gonzalez. I wanted to first thank the chairman for calling these hearings. I think they are so important and under very difficult circumstances, because I think the folks here ought to know that as chairman of the full committee, he has got this terrible mandate as a result of the budgetary restrictions.

We have been trying to work on that. He has been working day and night. He has gone out of his way to have this kind of meeting at this particular juncture.

I wanted the record to show clearly that I am very much concerned and very much interested in the process.

However, as you well know, I have two simultaneous meetings of subcommittees, one of which I am the ranking member, and it is a very important hearing underway, and another a markup in another and, therefore, I wanted the record to show that I was here but that I must necessarily leave, at least for this initial phase of the hearing and attempt to be back in sufficient time to either participate, ask questions, or submit questions for the record, if such is permissible.

Mr. **Mitchell**. Certainly. I appreciate your statement. It is a very difficult time for us right now. Every committee is working on reconciliation.

In addition, the House of Representatives went in at 10 o'clock, and I greatly fear from time to time we will be interrupted by recorded votes but it is the intent of the Chair to let the hearing continue, if we have to go for a vote.

We will simply recess and then come back in 15 or 20 minutes.

I am sorry I didn't see you here, Congressman Evans.

You plan to testify. You prefer to testify during the end of the day?

Mr. **Gonzalez**. If I may have that privilege.

Mr. **Mitchell**. Well, thank you, you too, Mr. Gonzalez.

Mr. **Gonzalez**. I beg your pardon. He is permitted to sit up here, isn't he?

Mr. **Mitchell**. Quite seriously, it was my understanding that you prefer to testify later in the day.

Mr. **Evans**. Whichever way would be more convenient, but I am prepared to testify now or later, whichever would be more convenient.

I do have some other commitments later on.

Mr. **Mitchell**. Well, fine; if you are prepared to testify at this point, we will be ready to move with you.

I have an opening statement from Congressman Addabbo for which I ask unanimous consent that it be submitted for the record.

OPENING STATEMENT OF HON. JOSEPH P. ADDABBO, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK

Mr. **Addabbo**. Mr. Chairman, again I thank you for holding these very important hearings. Today, we will have the chance to hear firsthand from 8(a) businesses their views of the problems as well as the successes of the program.

It is all too easy for SBA, the agency charged with implementing the program, to claim that "common business sense" requires that 8(a) firms be graduated from the program after 3 or 5 years. It merely provides SBA with an easy way out of its responsibility to provide genuine assistance to firms seeking to enter the economic mainstream. However, I find a 3-year, 5-year limitation as totally unacceptable. This proposal is in complete contravention of the intent of both Houses of Congress. More than 6 months ago, both the Senate and House rejected a proposal to limit program participation to 5 years. Now the SBA would impose a similar absolute time limit, only for 2 years less in the case of service firms.

Hopefully, these hearings will shed light on why Congress acted as it did, and will encourage SBA to go back to the drawing board if necessary to devise valid criteria.

The 8(a) program can only work with the full commitment of SBA to make it work. This requires Administrator Cardenas to make the necessary personnel actions which he promised at our last day of hearings. Let's hope he makes good on that promise very soon.

Finally, I thank the witnesses for taking the time out of their busy schedules to lend us their views.

Thank you.

Mr. **Mitchell**. Are there opening statements on this side?

Mr. **Hiler**. I don't have an opening statement, but I would ask that every consideration be given when we have witnesses, particularly witnesses that represent agencies and associations who are here frequently. We would appreciate receiving statements a little bit further in advance.

We didn't get our testimony last evening until close to 5 o'clock, and it becomes difficult to do the kind of study that is necessary to ask the best questions.

Mr. **Mitchell**. The SOP is that we try to have those statements in within 48 hours before the hearing.

Finally, we will put Congressman Evans on as our first witness. Before introducing him, like other members of the committee, I received a flood of letters in support of the 8(a) program. Most of them have come from businesses that have enjoyed the benefits of the 8(a) program.

Some of them suggest changes that I think are necessary for the program, and I think it would be enormously beneficial if the members of the committee, all the members, had access to some of these letters at least.

Therefore, I am going to ask unanimous consent that these letters I have with me this morning be entered into the record as a part of the appendix of this hearing.

Hearing no objection, they will be so ordered.

[Letters in support of 8(a) program follow:]

Delta-Eiro, Inc.,
Fort Worth, Tex., April 7, 1981.

Congressman Jim Wright,
1236 Longworth House Office Building,
Washington, D.C.

Dear Sir: It has been brought to my attention that in the near future, legislation will be introduced to terminate the 8(a) Program of the Small Business Administration.

Even though I do not qualify under the 8(a) Program, as a Small Business Person, this legislation is of great concern to me.

I know that cuts are being made in many areas of the National Budget, due to inflationary times, and I agree with many. However, in the area of small, Free Enterprise, I feel it is very important to maintain aid to the Small Business Man, minority or not. In a day when it is becoming more and more difficult, as a Small Business Person, to be competitive, it seems a disastrous proposal to take away the few advantages we do have.

It is an understatement to say that the large corporations are gaining more control, and I, as a business person and a Christian, must look to the future. Should I close my eyes to the fact that even though this legislation seems small and insignificant to many, will it have a snow-ball effect in the Small Businesses of America. If we neglect and ignore this, what will we shut our eyes and ears to next?

I realize there are problems within the Program, as there are in every worthwhile venture. But, wouldn't it be more appropriate to clean up the problems rather than to dissolve the entire program? There are many success stories that come from this program, and it has been very instrumental in breaking down the walls of prejudice in our country. Most important, it has helped many to become self-supportive, and given so much initiative to the minority group that they wouldn't have had otherwise.

Sir, I solicit your support as this legislation is introduced. We voted for the American Principles that America was founded on, one of the main ones being free enterprise, when we voted for you.

Sincerely,

Teri England, *President.*

STEPHENS ENGINEERING CO., INC.,
Mc Lean, Va., April 13, 1981.

Representative PARREN J. MITCHELL,
U.S. House of Representatives,
Washington, D.C.

DEAR MR. MITCHELL: Stephens Engineering Company, Inc., (SEC) is a Maryland Corporation and a U.S. Small Business Administration 8(a) certified minority small business. We have achieved this status during the past year after many years of diligent planning and hard work. We now wish to enlist your support for the U S. Small Business Administration 8(a) program so that all of our past efforts will not have been in vain.

The support of S.B.A. is critical for our survival and growth. Today's business climate is not conducive to the growth and prosperity of new minority small business ventures. We must compete in a period of runaway inflation and extreme uncertainty. Without the aid and support of the 8(a) program, we would have nowhere to turn for the necessary strength for positive growth. Since Stephens Engineering is in a most critical phase of growth and development, cutbacks in the 8(a) program could (would) spell disaster to our firm.

The S.B.A. 8(a) program is not a wasted handout of precious federal dollars. The program is an investment toward the future economic growth and stability of our firm. By growing into a strong, sound business venture, SEC will not only provide a possible business alternative to larger corporations but we will provide jobs and financial security for those whose lives depend on us. We need not mention that a healthy business also provides tax revenues for both state and federal budgets.

For years during my education, my service to my country as a Commissioned Naval Officer and as a Civil Service employee with both the Department of the Navy and the Federal Aviation Administration, I dreamed of the time that I could realize my special dream—owning my own healthy, growing business. Without S.B.A. support, we would lack the strong, guiding help so vital today. S.B.A. is not a crutch for life-long support, but a teacher providing education and experience.

Cuts in the 8(a) program will remove that support we so desperately need at this time. We will have to modify or scrap all of our planning if 8(a) is suddenly cut back or terminated. Without S.B.A., we would not have taken this most risky step. Should plans for a cut in the U.S. Small Business Administration arise, don't cut us off in mid-growth. A negative vote on budget cuts will be a positive vote on our future.

Thank you in advance for your time and support.

Sincerely,

WALLACE O. STEPHENS, *President.*

ASSOCIATED MINORITY CONTRACTORS OF AMERICA,
Washington, D.C., April 10, 1981.

Hon. JOSEPH P. ADDABBO,
House of Representatives,
Washington, D.C.

DEAR REPRESENTATIVE ADDABBO: The Associated Minority Contractors of America is a national trade association representing a significant portion of the 43,000 minority-owned construction firms nation-wide. At last count, these firms employed approximately 200,000 workers and indirectly impacted upon another 500,000 persons, dependent upon these workers in one form or another.

The current annual gross business volume for these minority-owned firms is three billion dollars. Absent impediments to their full participation in the construction industry, their annual gross business volume would be close to $24 billion.

That these firms are grossing three billion dollars is due in large part to the implementation of Affirmative Action "guidelines" within the construction industry. Legislation has been introduced which will terminate the 8-a program of the S.B.A., reduce Minority Business Development funding within the Department of Commerce from $24 to $20 million, reduce the Technical Assistance program to small businesses from $12 to $10 million, reduce agency staffing levels for Small and Disadvantaged Businesses, eliminate the S.B.A. Direct Loan Program, reduce by 25 percent the S.B.A. Guaranteed Loan Program and increase the S.B.A. Loan interest from 9¼ percent to market rate. Further, the Department of Transportation is considering changes in its regulations governing its M.B.E. Set-Aside Program.

Proposed regulatory changes would transform existing levels of required minority business participation into goals which can be fulfilled by a prime contractor's "best efforts". This difference between "requirements" and "efforts" is the difference between $3 billion and $24 billion—No Comparison! Therefore, we are requesting that you and your colleagues vote to defeat this legislation.

Sincerely,

MILTON G. CAREY, *President.*

WILLIAM GREAVES PRODUCTIONS, INC.,
New York, N.Y., April 17, 1981.

Hon. JOSEPH P. ADDABBO,
U.S. House of Representatives,
Washington, D.C.

DEAR REPRESENTATIVE ADDABBO: I was astonished to learn today that there is legislation currently pending in Congress to terminate the 8(a) program of the Small Business Administration.

Our company, William Greaves Productions, Inc, owes its existence and success to this program (see attached information). There are countless companies like ours in other fields of business enterprise whose development parallels and even exceeds ours. I cannot conceive of a Congressperson of the United States shutting the door on business opportunity to a class of citizens simply because of their racial or ethnic origins. The racial and ethnic discrimination realities of American life, past and present are well known to us all and these realities demand that the 8(a) program be continued.

Of equal importance is the fact that this 8(a) program created by Congress has succeeded in infusing more vitality into our free enterprise system. There has been a marked increase in jobs, increased tax revenue and improved economic health of both the minority and majority group sectors due to the 8(a) program. To terminate this program would be a highly destructive act that could further endanger the economic and social vitality of America. It would shut down a source of business and production ingenuity which is becoming increasingly critical to American competitiveness in world commerce. Finally and perhaps most importantly, it would imperil viable and productive trade with the third world in the twenty-first century.

Like myself, I assume you have a serious interest in an economically healthy America, I also assume that you are philosophically supportive of the positive forces in American civilization. If this is so, then I urge you to lend your important support to continuation of the 8(a) program and the other minority group programs of the Small Business Administration.

Thank you.

Sincerely,

WILLIAM GREAVES.

RIVERSIDE OIL,
Whitehouse, N.J., April 20, 1981.

Congressman JOSEPH P. ADDABBO,
House Small Business Committee,
U.S. House of Representatives, Washington, D.C.

DEAR CONGRESSMAN: We request that you support continuation of the Small Businesses Section 8(a) of Part 124, dealing with Minority Small Business and Capital Ownership Development Assistance.

The 8(a) program has assisted many minority firms to develop management skills and to learn to do business with our Federal government. These firms employ many minority community persons giving them a chance to be productive citizens.

Rather than being revised downward, this program should be expanded to provide the opportunities originally intended.

We thank you in advance for your support.

Sincerely,

STEPHEN RIVERA, *President.*

LEGENDRE JOHNSON & MCNEIL,
New York, N.Y., April 24, 1981.

Congressman PARREN J. MITCHELL,
Chairman, House Small Business Committee,
U.S. House of Representatives, Washington, D.C.

DEAR SIR: LeGendre/Johnson/McNeil Architects Planners is a certified Minority Business Enterprise (MBE) in Westchester County, New York. We are also members of the Westchester Minority Contractors Association, Inc., (WMCA) a trade association located in White Plains.

We have been presented many positive opportunities to enter the contracting mainstream, in large measure, due to the implementation of the 8(a) program and the retention of the minority programs in the Small Business Administration (SBA).

The changes which have been proposed for the 8(a) program and the uncertainty of what changes will become regulations for SBA direct loan program have already begun to impact negatively upon the minority business sector. Indeed, the ability of many minority businesses to continue to operate successfully is threatened similary.

We are therefore concerned that the 8(a) program and other programs of the Small Business Administration should continue to be funded.

Very truly yours,

HENRI A. LEGENDRE, *Partner.*

DIGGS CONSTRUCTION CO., INC.,
Wichita, Kans., April 21, 1981.

Hon. PARREN J. MITCHELL,
U.S. House of Representatives,
Washington, D.C.

DEAR MR. MITCHELL: I am writing to request your support to retain the 8(a) Business Development Program of the Small Business Administration. I understand that legislation will shortly be introduced to terminate this program.

The main goal of the 8(a) program is to enable minority contractors, such as myself, to get into the mainstream of the construction industry. Minority contractors have faced many obstacles due to the usual patterns of discrimination. The most critical barrier has been the inability to get experience and establish a "track record." More than anything the 8(a) program helps us to get the necessary experience and, if we have the ability, that experience in the public sector helps us get work in the private sector.

This program is benefitting our economy in two ways. First, it has enabled me as an 8(a) contractor to create jobs in this area, many of which are filled by minorities. Second, it has strengthened minority businesses. At the same time, it strengthens and stabilizes the minority community in which these businesses are located.

In summary, minorities are only participating less than 2 percent of billions of dollars spent by government. If this 8(a) program is terminated, minorities will have less of an opportunity to take advantage of the billions of dollars being spent.

Sincerely yours,

DALE G. DIGGS, Jr., *President.*

Mr. MITCHELL. Congressman Billy Lee Evans, a member of the House Small Business Committee, is a Representative from the State of Georgia.

I am delighted that you can testify for us. I miss having you over there in your regular spot. I know it must be a little difficult. I know you were in Georgia yesterday for the funeral of a former Member of Congress.

Anyway, thank you for being here and go right ahead with your statement.

TESTIMONY OF HON. BILLY LEE EVANS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF GEORGIA

Mr. EVANS. Thank you, Mr. Chairman.

I would ask unanimous consent that the prepared statement be submitted for the record in its entirety and I would like to talk extemporaneously on this bill.

Mr. MITCHELL. Without objection, so ordered.

Mr. EVANS. First, I would like to commend the chairman in the very fair way that he has conducted the hearings on this bill.

It is a bill which invokes a great deal of apprehension. I am very well aware of what the situation was prior to the institution of this program, and I know it is one of or probably the only program that is available to small business minority and disadvantaged people to help bring them into the mainstream of the business community in our country.

I am concerned, however, Mr. Chairman, that with the limited amount of resources that we have had available, that over the past 12 years, the way this program has been administered, that too many people have been left out of the program, because it has been in many instances directed toward creating large businesses out of small businesses, of changing the vocation of a number of people to put them into something that they knew absolutely nothing about.

Of course, I am aware of the other programs such as 7(j), to provide technical assistance to assist minorities in getting into other areas, and that is not so objectionable, if it works, but we have a program that has been in existence for 12 years.

We have had over 4,000 participants in that program from the standpoint of being admitted to the program.

We have had, I think, about 166 so-called graduates, and I seriously question whether some of those firms are even still in operation, although I have not been able to confirm this, because I have not been able to get the information from the Small Business Administration, and I don't think that they followed up to see what has happened to these businesses after they were so-called graduated.

We have had about 2,300 or 2,400 who have left the program. We have had 600 firms who have been admitted to the program but who have never participated.

So many of the complaints that I have had about the program have been from these people who have been able to get into the program but who have never gotten a contract.

We have had a problem also with the fact that just a few firms are getting the lion's share of the money and have the contracts.

I would like to read on the second page of my statement that socially and economically disadvantaged businesses have been encouraged to operate in a climate that is not conducive to equitable opportunity for all. Near the end of 1980, 65 8(a) firms had received almost one-third of the $1.2 billion in contracts awarded for 1980.

Present policy for contract support allows a firm to receive an unlimited amount of contracts and thereby seems to produce a highly skewed distribution of successful firms.

From the preliminary research, 3.5 percent of the 8(a) portfolio has received almost 30 percent of all contract awards—$5.5 billion—in the past 12 years. At the same time, one-third of the portfolio has not been awarded contracts for the past 3 years, at least 600 firms. Because a disproportionate number of contracts are going to an elite group, a larger number of firms are being denied support and assistance.

Now, I have attached to my statement certain information which reflects what is happening to the program. I might mention that the direction regionally has been very disproportionate.

My area of the country, for instance, 149 participants out of 72,000 small business disadvantaged and minority businesses have participated. In this region the figure has been 509 with about 42,000 disadvantaged and minority small businesses.

I realize that no administration can distribute contracts and funds exactly the same throughout the country, but I do think that there can be a more equitable distribution throughout all the needy people of this country that need the assistance that this program was designed to help.

It is always difficult to introduce a bill to abolish a program that has helped people and there is no doubt that 8(a) has been the savior for a number of minority and disadvantaged small businesses.

I fully expect these people to come before the committee and testify in favor of that, and I expect that this is the source of the letters that I have received.

At the same time, I think it is the duty of every Member of Congress to try to eliminate waste and mismanagement wherever they find it, whether it be in Defense or whether it be in Small Business, or minority programs, or anywhere else, because with that waste in the program, so many people who could participate and be helped are being deprived.

Now, the way my bill was drawn, it would provide 90 days for the Small Business Administration to offer an alternative way of accomplishing the goal that we set out to accomplish.

I know that these small businesses, and I use that term loosely when I am talking about firms who have received as much as $76 million in contracts, employ a lot of minority people, and I think it is wrong for a Small Business program to try to employ people through this type of program and, as I have stated to you before, if we have a need for help to firms in the upper- or middle-income range, we should do it through a different department other than Small Business.

We should do it through Commerce and I would be supportive of such a program as you would be, Mr. Chairman.

With the limited amount of money that we get into this program, I think it is highly unfair to the minority business people in my community and a lot of other communities throughout this country that they cannot get the help that they need by way of smaller contracts, by way of assistance, because we have had too much going to too few.

I know that the chairman is concerned about the termination of certain firms in this program.

I think without a method of termination or graduation, or leaving in some manner the program, that we are never going to have in this time of budget austerity the kinds of funds available to help some little people, and I want to see those people be made a part of the American business community and the American dream.

We can't do it if you have 50 firms getting one-third of the contracts and you can't do it if you have 3.5 percent getting most of the business development funds so, Mr. Chairman, that is why I introduced this bill, not in a sense of trying to take away the one thing that minority and disadvantaged businesses have but in the sense of trying to make this program respond in the way it should respond to the needs of minorities and disadvantaged business people throughout this country.

I think the bill has some merit in the sense that it would give us an opportunity to start over. It would give us an opportunity to start the program fresh without making the mistakes that have been made over the past 12 years.

I think it would give us an opportunity to bring businesses in under the proper guidelines without the need of the appellate process which many of these firms can exercise over the next year or two or longer, if they are in effect encouraged to leave the program.

I think that you and I can disagree on the number of years that this program should help a business, but I think that with businesses who have been in this atmosphere for at least 9½ years and continued to get contracts without competition, have continued to have the technical assistance provided by this program, who have continued to have the option of having cost overruns paid by the Small Business Administration and, Mr. Chairman, you can't tell me that that kind of atmosphere fosters a situation in which that business is going to be able to compete.

What we are doing is making a welfare situation out of that business where they don't know that they have got to start getting their house in order so that they can compete.

I know that even with the best of situations that it is still very difficult for minority businesses to compete under the system that has existed over the past 200 years, but I think that we have got to get those businesses to exercise the practices that they have to exercise with the realization that they will be leaving the program at a certain time or within a reasonable leadtime to come out of the program and compete in the private sector for these contracts.

I appreciate the chairman's hearing from me on this bill. I have had a number of bills introduced and which I never could get a hearing that the chairman was a lot more favorable to than you are to this bill and, again, I would like to express my appreciation for your fairness in hearing from all sides, and the fact that we have had four GAO reports which have been highly critical of the way this program has been administered and several committee hearings from the Senate, and there has been very little response to try to correct these.

We have had a bill passed to try to correct some of the problems. I have seen very little change from the study I have made, and I think we have to get the attention of the Small Business Administration, and that is no reflection on the present administration, because I think they have just come into it but it does let them know that all of us feel, and I think you share that, Mr. Chairman, that the program has to be corrected in order to serve the greatest number of small businesses and disadvantaged business people in this country.

[Mr. Evans' prepared statement with attachments follows:]

PREPARED STATEMENT OF HON. BILLY LEE EVANS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF GEORGIA

Allow me to begin our meeting today by explaining the controversial nature of a bill that I intend to introduce this week. You were invited here today because you already have general knowledge of and interest in the subject.

The bill (see Attachment 1.) will amend the Small Business Act of 1957, rescinding the Small Business Administration's authority under Section 8(a). The Congressional intent of the 8(a) program was to promote business development and to improve the competitive viability of minority small business firms. The office responsible for administering this program is the Office of Minority Small Business and Capital Ownership Development. SBA, pursuant to this section, may set-aside federal contracts on a non-competitive basis for eligible minority-owned businesses. I will also introduce legislation (see Attachment 2.) to terminate the 8(a) pilot program.

I am sorry to report, as have others, that after 12 years of operation, the program has been almost totally ineffective in meeting its objectives. The 8(a) program has allowed a limited number of minority small businesses access to non-competitive contracts, financial, technical, and management assistance, grants for business development, and interest free advance payments at a cost which may exceed one billion dollars!

Very few firms have graduated from the program (graduation presumes that the competitive viability of a firm increased as a result of SBA's assistance). Over 4,000 firms have participated in the program after being certified as "socially and economically" disadvantaged. Of these, only 166 firms have graduated and approximately 2,300 firms terminated, withdrew or failed while in the program. The remainder are still participating.

There are many, many problems. There are strong disincentives for participants to leave the auspices of the Federal Government. Goals and operating procedures encourage participants to view 8(a) contract support as an end in itself, not as a means to wider business opportunities. Program resources are limited, causing many firms to be denied entry into the program and presumably to be denied equal access to opportunities in the small business sector.

Socially and economically disadvantagted businesses have been encouraged to operate in a climate that is not conducive to equitable opportunity for all. Near the end of 1980, sixty-five 8(a) firms had received almost one-third of the $1.2 billion in contracts awarded for 1980. Present policy for contract support allows a firm to receive an unlimited amount of contracts and thereby seems to produce a highly skewed distribution of "successful firms." From the preliminary research, 3.5 percent of the 8(a) portfolio has received almost 30 percent of all contract awards ($5.5 billion) in the past 12 years. At the same time, one-third of the portfolio has not been awarded contracts for the past three years (at least 600 firms). Because a disproportionate number of contracts are going to an "elite" group, a larger number of firms are being denied support and assistance.

Another point that I am very disappointed in is the regional distribution of minority firms. This distribution is not by any means in proportion to the number of minority firms located in the region. For example: The participants in Region III (see Attachment 3) represent 27 percent of the total number in the program, while less than 9 percent of all minority businesses are located in this region. At the same time, Region II has over 20 percent of the total minority firms in the country but has only about 8 percent of the program participants. There is also no correlation in the regional percentage of minority businesses and the dollar amount of contracts awarded in each region.

The total cost of the 8(a) program since inception is estimated to be in excess of $80 million (see Attachment 4.). Program costs for the past 12 years can only be estimated because of the hidden cost covered in expenses for Minority Small Business Capital Ownership Development, 7(j) assistance, expected losses from outstanding advances, and costs accrued to the procuring agencies from offering 8(a) contracts in lieu of competitive bidding.

The program's administration has produced results that conflict with the original intent of Congress. Program goals and policy initiatives, lack of incentives for completion of the program, the volume and form of contract assistance, and the lack of a clear definition of programatic success have served to decrease rather than to increase the opportunities for minority businesses to compete in the marketplace.

According to the January 23, 1981 GAO report to Congress, "SBA approved the 8(a) firms that received these three contracts without adequately assessing their capability to perform. In GAO's opinion, SBA made a poor choice of Firms." GAO reported that one firm was awarded a contract even though the firm had not started work on its previous $70,000 8(a) contract until a year after it was awarded. GAO further pointed out that SBA district officials objected to the pilot award of $4 million because they believed the firm was not capable of performing. Despite this objection, the award was made, but only after SBA negotiated a joint venture arrangement which in effect placed most of the work performance in the hands of several nondisadvantaged companies.

Along these same lines, I received word that SBA was considering giving a multimillion dollar contract to a small company to develop and manufacture an alternative to a "jeep" vehicle for the Armed Services. Obviously a small business would not be able to handle such a contract, so their intention was to sub-contract to Chrysler! Can you imagine? Fortunately, this proposal has been thwarted.

I have here four GAO reports that cite problems with the 8(a) program, the last of which is a strong indictment of the administration. But GAO does not stand alone. The House Small Business Committee has been looking at the problem, the Senate Select Committee on Small Business has held hearings, and the Government Operations Committee has held hearings. Major publications in this country have done strong articles on this "promise unfulfilled." SBA has done nothing to right this wrong.

The results of GAO's review were discussed with SBA program officials. They had no comments regarding these deficiencies. GAO has published highly critical reports, terming the program ineffective; yet nothing has been done. In the latest GAO report on 8(a) from April 8, 1981, GAO notes, "Criticism, mostly justified, has come from many sources, yet meaningful corrective action has not been taken."

I also have here a copy of the First Annual Report on the State of Minority Small Business by the director of this project. SBA admits in its own analysis of the program, "The bottom line remains negative. The bottom line, though improved, has improved only slighly." Yet still nothing has been done.

I do not intend to sit back and allow this atrocity to go on any longer. SBA has not been responsive to either the Congress or to its watchdogs. For this reason, I see no other alternative than to abolish the program altogether. I want you to note at the end of the bill I have made a recommendation for the necessity of a new subcontracting program. Not later than the 90th day after the date of the enactment of this act, the Administrator of SBA shall be required to submit recommendations for legislation which will carry out the original plan to assist minority businesses more effectively.

I firmly believe that we must reinforce whenever possible the small businesses of this nation in their endeavor to participate in government contracts. I also plan to introduce a bill (see Attachment 6) to amend Section 15(a) of the Small Business Act to eliminate the appeals process in disputes over small business contract set-asides. A dispute arises when SBA recommends a contract be set-aside for small business and the contracting agency disagrees.

In its present form, when SBA determines that certain criteria are satisfied and recommends that a requirement be procured under a small business set-aside and the recommendation is rejected by the contracting officer, the SBA must appeal this rejection to the Secretary of the Department or the head of the agency involved. Historically, the final determination of these appeals has been less than 30 percent in favor of SBA's recommendation. (see Attachment 7)

An appeal is lengthy and time consuming, averaging in excess of 60 days. Pending final determination, the proposed contract is held in suspension, causing unwarranted delay in the procurement process. My amendment would provide for an automatic set-aside upon SBA recommendation, however, should a procuring agency fail to receive adequate bids during the specified invitation period from responsible small business concerns, the agency may unilaterally determine to resolicit or re-advertise on an unrestricted basis.

What I propose is to assure small business the maximum opportunity to participate more fully in government purchases while protecting the procuring agency's directive to obtain its requirements in the most advantageous manner.

I believe that this legislation will open up more contracts to small business, thereby opening more contracts to minority small businesses.

Thank you for your interest.

ATTACHMENT 1

[H.R. ——, 97th Cong., 1st session]

A BILL To amend the Small Business Act to repeal the small business subcontracting program under section 8(a) of such Act, and to direct the Small Business Administration to recommend to the Congress a more effective method of furthering the purposes of such section

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SHORT TITLE

SECTION 1. This Act may be cited as the "Small Business Development Program Improvement Act of 1981".

FINDINGS AND PURPOSES

SEC. 2. The Congress hereby finds and declares that—

(1) there is a need to assist certain small business concerns which lack the opportunity for full participation in our free enterprise system, and

(2) the implementation of subsection (a) of section 8 of the Small Business Act does not adequately and effectively further the purposes underlying such subsection.

REPEAL OF SECTION 8(a)

SEC. 3. (a) Subsection (a) of section 8 of the Small Business Act is hereby repealed.

(b)(1) Subparagraph (A) of section 2(c)(2) of such Act is amended—

(A) by striking out the period at the end of clause (iv) and inserting in lieu thereof "; and",

(B) by striking out "pursuant to section 8(a) of the Small Business Act" in clause (v),

(C) by striking out "; and" in clause (v) and inserting in lieu thereof a period, and

(D) by striking out clause (vi).

(2) Subsection (e) of section 2 of such Act is hereby repealed.

(3) Paragraph (1) of section 4(b) of such Act is amended by striking out "sections 7(j) and 8(a)" and inserting in lieu thereof "section 7(j)".

(4) Paragraphs (1) and (2) of section 4(c) of such Act are each amended by striking out "7(l), and 8(A)" and inserting in lieu thereof "and 7(l)".

(5) Paragraphs (1) and (2)(C) of section 7(j) of such Act are each amended by striking out ", 7(j)(10), and 8(a)" and inserting in lieu thereof "and 7(j)(10)".

(6) Paragraph (1) of section 7(j) of such Act is amended by striking out ", to small businesses eligible to receive contracts pursuant to section 8(a) of this Act".

(7) Paragraph (3) of section 7(j) of such Act is amended by striking out ", and with small businesses eligible to receive contracts pursuant to section 8(a) of this Act".

(8) Paragraphs (3), (8), and (9) of section 7(j) of such Act are each amended by striking out ", 7(j), and (8)(a)" and inserting in lieu thereof "and 7(j)".

(9) Paragraph (4) of section 7(j) of such Act is amended by striking out "and small businesses eligible to receive contracts pursuant to section 8(a) of this Act".

(10) Paragraph (10) of section 7(j) of such Act is hereby repealed.

(11) Paragraph (11) of section 7(j) of such Act is redesignated as paragraph (10) and is amended by striking out "and small business concerns eligible to receive contracts pursuant to section 8(a) of this Act".

(12) Subsection (k) of section 7 of such Act is amended by striking out ", 7(j) and 8(a)" and inserting in lieu thereof "and 7(j)".

(13) The last sentence of subparagraph (C) of the clause contained in section 8(d)(3) of such Act is amended by striking out ", or any other individual found to be disadvantaged by the Administration pursuant to section 8(a) of the Small Business Act".

(c) This section shall take effect on the 180th day after the date of the enactment of this Act.

LEGISLATIVE RECOMMENDATIONS FOR NEW SUBCONTRACTING PROGRAM

SEC. 4. Not later than the 90th day after the day of the enactment of this Act, the Administrator of the Small Business Administration shall submit to the Committee on Small Business of the House of Representatives and the Senate Select Committee on Small Business recommendations for legislation which will carry out the purposes specified in section 2(c) of the Small Business Act more effectively than such purposes were carried out under section 8(a) of such Act.

ATTACHMENT 2

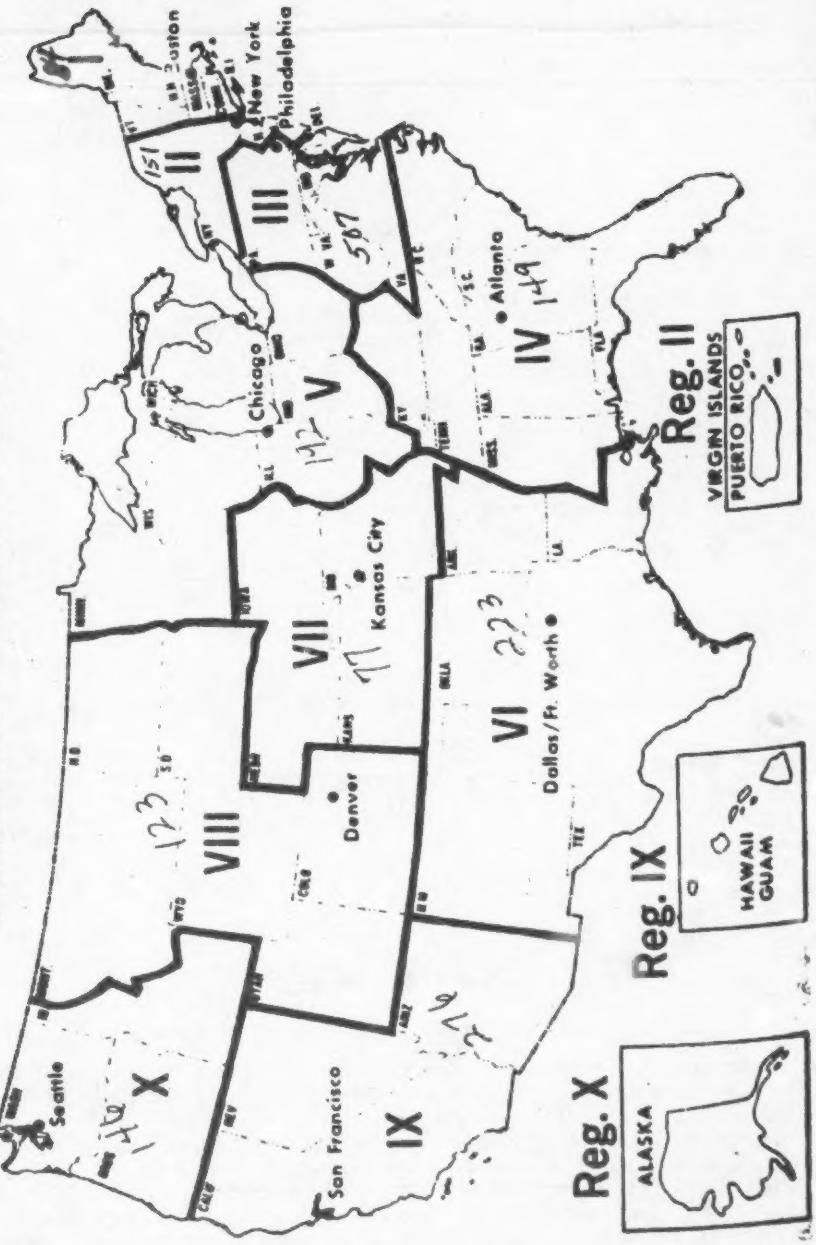
[H.R. ——, 97th Cong., 1st session]

A BILL To amend the Small Business Act to terminate on June 1, 1981, the pilot program for small business set-asides under section 8(a)

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the last sentence of paragraph (1) of section 8(a) of the Small Business Act (15 U.S.C. 637(a)) is amended by striking out "September 30, 1981" and inserting in lieu thereof "May 31, 1981".

ATTACHMENT 3

STANDARD FEDERAL REGIONS


I
Boston
II
151
New York
Philadelphia
III
587
IV
Atlanta
149
V
Chicago
192
VI
Dallas/Ft. Worth
223
VII
Kansas City
77
VIII
Denver
123
IX
San Francisco
276
X
Seattle
146
Reg. II
VIRGIN ISLANDS
PUERTO RICO
Reg. IX
HAWAII
GUAM
Reg. X
ALASKA

BEST COPY AVAILABLE

ATTACHMENT 4

8(a) EXPENSES 1974 THROUGH 1981

	Contracts [1]	Business development funds [2]	Salary and expenses [3]
1974	$278,300,000	$6,000,000	$2,200,000
1975	320,500,000	6,900,000	2,600,000
1976	385,100,000	8,400,000	3,400,000
1977	564,400,000	9,700,000	3,800,000
1978	768,200,000	10,900,000	4,200,000
1979	1,018,400,000	11,700,000	4,900,000
1980	1,569,900,000	20,600,000	7,200,000
Total	4,901,800,000	74,200,000	28,300,000

[1] The figures under the Contracts heading represent the dollar amount of contracts awarded 8(a) participates under the program.
[2] Business Development Funds include startup cost for new businesses and cost differential reimbursement on the above contracts.
[3] Salary and expenses are those of SBA employees.

ATTACHMENT 5

Total small business (minority)

Region III (number of 8(a) participants, 507):	
Virginia	11,891
West Virginia	909
Maryland	11,345
District of Columbia	8,039
Delaware	944
Pennsylvania	10,830
Total	43,958
Region IV (number of 8(a) participants, 149):	
Mississippi	5,220
Alabama	5,599
Georgia	10,637
Florida	22,803
South Carolina	7,621
North Carolina	11,680
Tennessee	6,123
Kentucky	2,735
Total	72,418

ATTACHMENT 6

[H.R. ——, 97th Cong., 1st session]

A BILL To amend the appeals process for small business set-asides

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) subsection (a) of section 15 of the Small Business Act of (15 U.S.C. 644) is amended by striking out the words "and the contracting procurement or disposal agency" as they appear following the word "Administration" as it first appears in this section.

(b) by striking out the last sentence of this subsection and inserting in lieu thereof the following: "However, should a procuring or disposal agency fail to receive bids or offers from two or more responsible small business concerns on any procurement or sale reserved to small business concerns under the provisions of this Act; the procurring or disposal agency may unilaterally determine to resolicit or readvertise the requirement or sale on an unrestricted basis."

(c) The amendment made by this action shall take effect on the date of enactment.

Attachment 7

15(a) APPEALS RESULTS

	Total	Won	Lost	Canceled [2]	Reversed [3]
1980	26	6	18	1	3
1979	15	5	9	1	2
1978	21	7	13	1	2
1977	15	3	10	2	
Transition [1]	5	3	2		
1976	22	5	16	1	
Total	104	29	68	6	7

[1] The transition period was for July 1-September 30, 1976.

[2] The Cancelled heading is for cancellation of the requirement by the agency, except for the one in 1980 when the SBA withdrew its recommendation.

[3] The reversals are included in the Won column but were not decided by the Secretary of the Department involved.

Mr. **Mitchell**. Thank you very much for your testimony.

I might indicate, no matter what my feelings are one way or another, as long as I am chairman of this committee, every piece of legislation that is submitted for consideration will be given ample consideration.

I would like to comment on one or two things before I ask you some questions.

I, too, share the idea that firms ought to be graduated from the program. I think the only point of difference is how they are graduated and under what circumstances.

I think you will recall that I sent to your office a document last week which suggests a possible mode of transfer involving the Department of Commerce and I hope you received it. We agreed that we would work on that together.

In addition to that, there is one other comment I would like to make.

My office, the library in my office, is replete with studies done by the GAO and other agencies of Government and these studies have been highly critical of many agencies of Government, and I think that is good, but in no instance have we ever seen an attempt made to simply abolish a program without any attempt being made to give it a chance to straighten itself up.

In your bill, you said that you were giving 90 days to the Administrator to come up with a program that would guarantee a more efficient operation, and I hope that that will happen and it will not be necessary for us to act on your bill.

A couple of questions about the percentage or the disproportionate number of firms participating in the program.

Do you think that certain contracts which deal with high technology would almost preclude some small businesses from even bidding on those contracts or being interested in getting an 8(a) contract?

Mr. **Evans**. As I stated, I don't think there is any way that you can have an exact distribution throughout the country and, of course, you have certain firms located around the Washington, D.C. area that would be more prone to bid on and receive contracts in highly technical areas.

There is no doubt about that and that is probably a part of the reason for the inequitable distribution, but I think at the same time that there has to be a more equitable distribution in order to get the——

Mr. MITCHELL. Oh, I am in agreement with you.

Mr. EVANS. I agree that that is part of the reason.

Mr. MITCHELL. I am trying to go through and isolate some of the factors that might account for this maldistribution, and we are in agreement if it is a highly technological contract that precludes a number of minority firms from expressing any interest in this because they don't have the capability.

Mr. EVANS. We have had instance after instance of the SBA technical advisors going out and changing or trying to change the thing that that particular small business did, such as the food processor in California that was made into a defense contractor that was to make parts for weapons systems.

If you do that in certain areas, you can do it in others. I think it is probably a bad idea to do it. There are enough legitimate small businesses to do work.

Mr. MITCHELL. I am still trying to isolate some factors out in my mind which might account for a maldistribution.

One of them is that it is a technological contract. Would the matter of the size of the contract enter into the picture?

For example, if the Department of the Interior put out a very, very large contract, would not the sheer size of it prohibit some minority firms from expressing interest in it?

Mr. EVANS. I think that is true, too.

Mr. MITCHELL. We have two problems. We have been fighting for years to get those contracts broken down into smaller ones so more can compete, but there are two possible explanations as to why there has been a maldistribution of the contracts.

I was thinking during your testimony, I work with a large number of 8(a) firms across the country and those seeking to become 8(a). Some are good and some are bad and some are more aggressive than others.

Would not the matter of the aggressiveness of a firm in pursuing a contract, would that not enter into the picture?

For example, if one firm comes in and the first time it is turned down says, OK, I quit, and another firm comes in and is turned down and comes back five more times and battles for what they want.

Don't we have to deal with the problem of aggressiveness in the firms? Would that not be a factor which might account in part for the maldistribution?

Mr. EVANS. I am not sure I can agree with the chairman on that, that that should be the way it is.

If a firm needs the help it should be more on a first-come, first-serve basis, not on who can get the right person to contact the agency.

Mr. MITCHELL. I don't mean that at all.

Mr. EVANS. I am not trying to put that into it, Mr. Chairman, or whoever comes back and makes proposals over and over again.

Maybe that is the way life is, and certainly that could account for some of the problem, but I am not sure that it should.

Mr. MITCHELL. The point I am trying to make is not that a firm is turned down and goes to somebody for help and gets a contract. I am talking about the firm that is turned down because there is something wrong in its original submission. If it is not a very aggressive firm, he will say, look, I made all this effort and why should I bother to change?

My knowledge suggests that there has been as many as eight different times a firm has had to change its original submission, and that is kind of tough if you don't have a real aggressive spirit.

So we have maybe three factors that account for the maldistribution.

Mr. **Hiler**. I would like to comment on that last comment.

I am not sure tenacity or aggressiveness would necessarily be a regional characteristic.

Mr. **Mitchell**. I am coming to that later on, so I will reclaim my time.

I do want to consider that.

There is a fourth possible explanation for the maldistribution, and all the members who serve on this committee are fully aware of that fourth possible explanation, and that is that the Federal agencies of Government have been almost totally resistant to letting contracts.

You have to fight tooth and nail. I pointed out in a prior hearing that no President, Mr. Nixon, Mr. Ford, or other President, has ever met the goals for minority business enterprise in a given year primarily because of the resistance, the bureaucratic resistance, on the parts of the agencies in terms of setting aside certain contracts for 8(a) use. I think it is obvious to me that if you limit the size, if you limit the size of the number of contracts that these agencies are willing, well, if you limit the number of contracts that these agencies are willing to let, once again you begin to preclude.

With your point, Mr. Hiler, it is a problem and I agree that the regional distribution area is perhaps the most difficult and it seems to me the largest part of the problem.

Unfortunately, that same condition obtains across the board. I would like to see the Southern States get their fair share and the Pacific Northwest get their fair share, but generally what has happened in terms of the Department of Defense and almost every other contracting operation that we have, you find firms that are able to set up an operation here in Washington, and because of their proximity and because they are more persuasive, I suppose, we do find a maldistribution in terms of regions, and I personally would like to address that problem with you and the members of the committee.

I have been in the Pacific Northwest on many occasions, and I find that there is a disparity there. I have made two trips to Alaska to find that the minority businesses in Alaska are not faring as well, so with reference to that point in your testimony, I think we are in agreement.

I have no other questions.

Mr. **Evans**. If I might respond, Mr. Chairman, and, of course, if we can get this other bill which I introduced through that would allow small business to avoid the appellate process when they select a contract for the general small business community, I think that we would have the opportunity for more small businesses to participate, including minority disadvantaged small businesses.

Mr. Mitchell. Let me just say that I have serious concerns about the operations of some of the regional offices.

You get widely varying patterns in terms of the effectiveness. Some regional offices are very effective and others are not. The lack of effectiveness of the regional office may in and of itself contribute to the regional maldistribution.

Congressman Hiler?

Mr. Hiler. Thank you, Mr. Chairman.

Congressman, have you discussed your proposals with the new SBA Administrator?

Mr. Evans. Yes, sir.

Mr. Hiler. What were his general comments?

Mr. Evans. Well, I think I can fairly say that the new Administrator is supportive of the program and would like to address the problems that I have raised and some that the chairman has raised, and I think that probably at that point he would be in favor of administering the program maybe a little more in line with my ideas than the chairman's.

That may be some of the problem he is going to have.

Mr. Mitchell. If the gentleman will yield, I don't think the chairman has delineated what his approach is.

Mr. Evans. I refer to one particular thing, and that is the length of time that people are under the program and I think that was a proper judgment. I was listening to your statement and making a judgment from that, but I would say that I think the response to your question is, Mr. Cardenas does support the program and does intend to continue the program.

Mr. Hiler. You mentioned that within 90 days after enactment, there would be an alternative proposal brought forth from the SBA and presented to the Congress.

Do you have any ideas of what you would like to see in that proposal?

Mr. Evans. Certainly I do, and those are basically the things I addressed.

I would like to see some method of providing a limit on the length of time that a firm could remain in the program. I would like to see a limit on the number of contracts that could be awarded, depending on a number of different alternatives, such as the size of the contract, the profitability, and this type thing.

I would like to see a formula for more equitable distribution throughout the country, and I would like to see the opportunity for more agencies to participate in this program and some means of making those agencies more responsive to the program, and I think the chairman is entirely correct on what has occurred and the reluctance of agencies to participate.

I am sure there are a number of other things, but there is no reason that this program cannot work with the proper regulations governing the entry into and the participation in the program by disadvantaged and small business firms, but I think the overall objective should be to expand the program into more, or to help more people than it is presently helping.

Mr. Hiler. From your research, do you have any idea what is the total percentage of minorities that participate in business?

Mr. Evans. That is 3.5 percent, much less than their population or their business percentage. I think it is about 3.3 percent. I may be wrong on that.

Mr. Hiler. Do you have any idea what percentage of that 3.3 percent is included in 8(a)?

Mr. Evans. I don't know the answer to that, but I think the 8(a) program has certainly helped to hold the line.

I think probably we could have had a reduction without the 8(a) program.

Mr. Mitchell. Would you yield very briefly?

Mr. Hiler. Yes.

Mr. Mitchell. Would you have data to show how many minority firms in your region have applied for 8(a) certification?

Mr. Evans. I don't have the number. I know only 149 in the eight States have been admitted to the program.

Mr. Mitchell. Obviously, I think we need to find out how many have applied. If 200 have applied——

Mr. Evans. Our laws only require the SBA to keep those records for 1 year. It is difficult to reconstruct the figures.

Mr. Mitchell. I am on the gentleman's time, but I want to pursue that because I think that is critical.

Mr. Evans. I have had a number of complaints from people in my area who have applied and not been able to participate, and I have had some from minority business from Columbus and other areas that have been admitted but never gotten contracts.

Mr. Hiler. No further questions, Mr. Chairman.

Mr. Mitchell. Mr. Daub?

Mr. Daub. I first want to apologize for being a little bit late.

I would ask unanimous consent to have my prepared statement entered into the record.

Mr. Mitchell. Without objection. It will be entered into the record.

Mr. Daub. I share the chairman's commitment to developing an effective 8(a) program, and I serve on the Government Operations Committee which has, with our colleague John Conyers, held a set of hearings in oversight to commence to look at this program from the standpoint of how effective it is currently.

To share that information with the Congressman testifying, I want to add that Morris West wrote a book entitled "The Devil's Advocate," and it might be appropriate to commend you in that regard, because whether we will all agree or disagree, it is important that this careful examination occur. I want to commend you for taking the bull by the horns and raising the issue in clear perspective for us to wrestle with.

I share many of your concerns and I have many complaints of record in my own hometown of Omaha, Nebr.

Mr. Hiler has asked the questions I would have asked, so I want to commend you for being here and for helping us to see the problem in a clear way.

I want to make it effective and I think you do too, and we appreciate your time today.

[Mr. Daub's prepared statement follows:]

PREPARED STATEMENT OF HON. HAL DAUB, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEBRASKA

Thank you, Mr. Chairman, I am very glad that we are having this opportunity today to hear from these witnesses concerning the Small Business Administration controlled section 8(a) set aside program.

This program has suffered from a great deal of adverse criticism and I fear that unless remedial measures are taken the program's reputation will be irrepairably damaged.

I am in agreement with the basic thrust of the program but am convinced that its real goals and methods to reach those goals have never been defined. Earlier this year when I was investigating the operation of the program in my own district I was struck by the inability of anyone to answer certain questions I had until I realized that there was no answer. For instance, at what stage will you have considered company X to have outgrown the program? Because there is no set basis for "graduation" that question was without answer. I am hopeful that the SBA will introduce reforms that will salvage the reputation of the program but I believe that Congress must give the agency more direction as to which way the program will be going in the future.

I look forward to reviewing the testimony that is presented here today to give me a broader view of the program than I currently possess. I have open mind as to the specific reforms that Congress should enact but I am very certain that they are necessary.

The goal of bringing more and more historically disadvantaged persons into the mainstream of this country's economy is a most important one. I am confident that there are no obstacles that cannot be overcome, but it will be necessary to pursue this goal in a thoughtful and innovative fashion, programs designed to be window dressing or that help only a few are not what we need.

Thank you Mr. Chairman.

Mr. MITCHELL. Thank you.

Mr. Smith?

Mr. SMITH. Thank you, Mr. Chairman.

Two questions: The first is, could you itemize some of the past reforms of the 8(a) program and how they have fared over the last 12 years?

Mr. EVANS. It is very difficult for me to do that, and I think the passage of the bill, it was 2 years ago, was supposed to address the graduation issue, for one thing, and I am not sure what else it was supposed to address.

I have not been satisfied with the implementation of that but I would certainly yield to the chairman to respond more fully.

Mr. MITCHELL. Yes, and I will do it in a kind of rambling fashion. There have been some reforms, and one major reform has been over the last 10 years, that we have broken the attitude within the SBA that confined minorities just to miniscule contracts. For years that was a standard policy in SBA, that is you wanted to open up a business you received $37,500.

That was just enough to guarantee the failure of the business so in that sense there has been a very positive reform, not through legislation but through constant piloting and oversight by this committee.

Under the terms of Public Law 95-507, SBA has been empowered to exert more pressure on these agencies which have been reluctant to let contracts to minorities.

That is an extraordinary piece of legislation and we have seen some differences in the number of contracts and the agency participation as a result of that.

Let me hasten to add that I am not satisfied with the program in its entirety and there are many reasons why.

I have always maintained that I think it has been a serious mistake to staff the Small Business Administration on the basis of political cronyism, and to staff it on the basis of persons not having, well, who never had experience in business.

We have not had much success in reforming the personnel problems that exist. There are others, and I will be delighted to share those with you.

Mr. SMITH. Have the problems of graduation and some of the other problems indicated in your testimony been addressed in other Congresses? Is it fact that there has been a lack of movement on those proposals?

Mr. MITCHELL. In the last session of Congress, at a hearing we instructed the then Administrator of SBA to come up with a workable graduation program and suggested that before it be implemented that it be submitted to the Congress for review to make sure it was effective and fair.

To the best of my knowledge, that was not ever submitted by the past administration; is that correct ?

Mr. CLARK. No.

Mr. MITCHELL. They did not submit it. The new Administrator, not through any fault of his own, is attempting to do this and violating what the Congress suggested which said bring it to us and let us review it.

Mr. SMITH. Rather than waiting the 90 days that you indicate that your bill if passed would do, to come up with some legislation that would begin a new program, wouldn't it be more advisable to have a program right now or a piece of legislation that would initiate such a program because that way, my understanding of what you have said is you are in favor of the goals of the 8(a) program; you just don't like the implementation.

Mr. EVANS. In spite of the fact SBA has not responded in the manner they should have to the problems that have existed, they certainly have the experience over a 12-year period to know what the problems are and I think they are better equipped than I am to come up with the type of legislation that would implement the best program.

Now, I could have sat down and drawn up a bill that would address some of the problems that I am aware of, but I would not have had the experience and in the administration of this program to best formulate legislation that would do a job for what I think to be the greatest number of people that have the need for it.

The mere introduction of legislation with the serious intent to pursue it sometimes serves as the kind of stimulation necessary to bring forth legislation that will address those problems.

I think and hope that this will occur. My legislation would take effect on the 180th day after the date of enactment, which would give 180 days in effect to come up with a different program.

It requires them to come forward in 90 days and gives us 90 days to perfect it but I think Congress cannot, without the input of the SBA and their experience, come up with the best program.

Mr. SMITH. OK; thank you.

Mr. MITCHELL. Thank you very much, Mr. Evans.

Let me just say for the record, we pursue similar objectives. The tactics are different and, therefore, I am in vehement opposition to your piece of legislation.

I share your objectives but I think it is kind of dangerous to force a closing of the program unless you have a viable alternative in place and that has to be reviewed by the Members of the Congress and I know you suggest something along those lines in your bill.

I would also be very wary, given the present climate in America, of closing down any minority programs. I think once they are closed down, given the kind of climate that we are witnessing now, it is obvious that minority concerns are no longer high priorities for America, if you close one day, it will be exceedingly difficult to open another.

Mr. EVANS. I would be sorely disappointed in you were you not opposed to my legislation.

Mr. MITCHELL. Mr. Evans, I try never to disappoint you.

Thank you very much.

We do have a vote on, and it is a recorded vote.

I would suggest that we stand in recess for 15 minutes while the Members make their vote and come back.

The committee stands in recess for 15 minutes.

[A short recess was taken.]

Mr. MITCHELL. We can proceed without the other Members.

We better proceed.

Our next witness is Mr. Rotan E. Lee, an attorney.

Mr. Lee?

TESTIMONY OF ROTAN E. LEE, ATTORNEY

Mr. LEE. I have a prepared statement that I would like to submit for the record, with the consent of the committee, and make reference to it throughout my remarks.

Mr. MITCHELL. Without objection, your prepared statement will be entered in its entirety for the record.

Mr. LEE. I am very glad to be here.

It is unusual to sit on the other side of the bench, after having an opportunity to work with you for so long for so many years.

Mr. Chairman, I am very, very concerned about what is happening with minority business enterprise today in this country.

I think that what exists today is a tremendous misconception on the part of the American people about what constitutes minority business and economic development today.

I think that we are still referring to small marginal businesses as opposed to taking a look at the tremendous growth that has taken place in the minority business community, to the extent that we have the kind of potential to produce a substantial economic base in the economic community where we can begin to discuss parity in some realistic terms.

I was listening very carefully to Congressman Evans today, and I believe, without trying to be pejorative of his comments, that it is indicative of a kind of civil rights approach for economic development for minorities to believe that the great development will occur by providing the greatest opportunity for the greatest people in numbers as opposed to providing opportunities for those companies that have a potential to develop a kind of economic basis that would rival the similar basis in the minority community.

I think the issue is about quantifiable, qualitative approaches in economics. I am not interested in having $2 million fledgling minority businesses in the United States. I would much rather have 200 substantial companies that have a developmental base to produce jobs and an investment factor in the minority, so the issue is not a numerical one.

It is part of the civil rights movement, yes, but different than voting where numbers is the issue, but here qualitative reality is the issue.

There are two reports that I would like to make reference to with some brevity, but they are very, very important. I have made reference to them in my testimony.

One of the reports is a report by the SBA task force on "Venture and Equity Capital for Small Business", and another is a special report by the Small Business Administration on "Small Business Financing by the National Association of Securities Dealers".

Those reports were all developed over the last 5 years and, interestingly enough, they don't talk about minority business at all. More importantly, they talk about economic development of small business in a society that is becoming more and more encroached by large businesses, and I sort of have to be somewhat humored by it when someone tells me about a large minority business.

It is sort of like talking about a large, small, small business, and you get into the problem with the adjectives where they don't make any sense, and sometimes people are swayed by adjectives because they have no idea of the universe they are dealing in.

One of the fifty companies which has been identified on the hit list as a large company is one doing $76 million, and Exxon Corp. turned $103 billion. Well, I am very, very concerned that we are talking about something that is not small. We are talking about something that is so infinitesimally small in this economic system it doesn't even make any sense to try to debate the adjective.

The reports I was referring to may be given greater credence because they don't speak about minority small business. They talk about economic life cycles, the life cycle of a business, how long it takes.

When I was coming up and going through school, we used to have the three R's, reputation, resources and rapacity.

Reputation is who are you, where you are from. That was the whole thing about minorities going to school. We got to get the degrees, get the law degrees, the B.S., et cetera, to develop the reputations necesary to meet that first.

Then the resources come up, and they have never come. It has always been a trickle-down theory of resources. We have never had the opportunity to amass the kinds of resources necessary to really enter into the economic mainstream, and to the extent that this report sets out a chart that covers a 15- or 20-year period, it talks about the first three-quarter life of the business being involved in private investment where the individuals themselves generate that investment and they have to look to the marketplace to find the investment and, without it, they cannot grow before they can even begin to talk about what is the ultimate pinnacle of success when the business market today is going public and doing it for real, and we are not even close to talking about minority business in this country with a reality of going public on the stock exchange in any respect.

Those resources, the actual basis of the finances necessary to produce have not been forthcoming. They don't exist.

The other side of that resource has to do with the marketplace, because you can't talk about capital if you can't talk about markets. Part of the reason the 8(a) program is so important for those minorities today, and they are struggling to keep it, really has nothing to do with gift programing, but protection of a marketplace that in the absence of an 8(a) program would not exist.

We are not talking about companies that are trying to hold onto a marketplace from a welfare position, because it is the only market that will provide them with service. It is the only market that they can provide incompetent services to. That is not true.

We are talking about businesses that provide competent services that, given the opportunity to compete fairly in an unobstructed system, they wouldn't even need the 8(a) program, but it is more important to a political matter to keep racism away from the market system.

It is the only single source of defense that the minority business community has in the Government marketplace sector today, to keep racism as reasonably away from the Federal marketplace as possible.

In the absence of the 8(a) program, and part of the reason for the passage of Public Law 95-507, and I was one of the persons who worked laboriously putting the language of that piece of legislation together, was to further prevent the encroachment of racism into a system that would otherwise deny minorities an opportunity to deal in the Federal procurement marketplace at all, not in part but at all.

The other side of that is that the 8(a) program is under the impression that it is providing this multiplicity of technical services to those companies to become better economic entities. Most of the companies that have succeeded in the 8(a) program today are as fiscally and managerially accountable as any white companies of similar growth levels.

The 8(a) program cannot come in and provide to those companies in most cases fiscal accountability when they can provide those services from Peat, Marwick & Mitchell and Arthur Anderson, et cetera. The competency level is not with the companies and their inability to demonstrate those accountabilities, but in the SBA program in its inability to deliver the services where the accountabilities are necessary for those companies to grow.

This is not all of the companies, certainly, and Congressman Evans is right, there is a vast universe of potential entrepreneurs that exist today in this country, and many of them want to operate very marginal businesses, and I don't mean that in a negative sense, but people who want to start a business and who are not interested in escalating growth, but there are people in this country today who are black, brown, and Indian who have just as much energy, vigor, competence, and ego to talk about building

A.T. & T.'s, ITT's, Boeing's, and Rockwell's, and the like; and I am saying in the absence of the market, in the absence of the money, those possibilities don't exist.

The problem is partly in the attitude of the Congress and the attitude of the Government as it relates to what their perspective of minority business really is or is not.

The fact of the matter is, we are talking about developing an economic community base for minority people in this country, and to do that requires the massive injection of capital to build the businesses that are necessary to develop the jobs and the investment factor to create a reasonable basis of a cyclical reality within the minority community today, whether that happens to be Detroit or Peoria, Ill.

The fact of the matter is the issues involved are no less real in the minority economic community than they are in the economic community as a whole. I made reference to that in my testimony when I said that this is not about creating a black millionaire class, and I made a statement and used the word white people really don't spend a lot of time trying to figure out how much the presidents, chairmen of the board, and chief operating officers of those major corporations of the United States are making.

Once in a while it becomes a feature issue in one of the major papers, like the other day when they made an issue of how much money the Secretary of State was making when he was working with United Technologies, which I can tell you was probably more money than the net worth of some of the companies we are talking about today on an annual salary, but it did not become an issue, and there appears to be some type of information factor that exists about this developing, evolving class of black millionaires who are going to do something or be something or whatever that case may be.

It is really not about that. It has nothing to do with that, and I am very sick and tired of hearing at the agency level, we don't want to make black millionaires, and I am saying, we need to have black millionaires because it is that millionaire class of environment that is primarily responsible for the private placement of capital in the society today for the economy to evolve.

That is exactly the kind of economic class you need to create, and I am saying that the Small Business Administration, the Federal Government as a whole, is not helping in that process.

I wanted to make a reference again to this other report, because I would like to put those in the record, and I am going to submit them to the chairman so that you may be able to produce copies and provide them to the other members of this committee.

I am sorry they are not here. One of the reports, the chairman of which was Mr. William J. Casey, who is now the head of the Central Intelligence Agency, and this report very clearly stated that you need about 15 or 20 years in order for you to really reach that cycle of business growth where you can claim that you have matured.

We are talking about companies that have been around for 12 years, and I am not really interested in the last 400 years of slavery. Without being comical, but allowing a certain comedy in the criticality of my remarks, I am really interested in the last 120 years when the first time the white American ever talked about blacks in economic reality was 40 acres and a mule, and the 8(a) program are the only two times that I have ever heard in either reading or believing that blacks have been involved in some type of recognition by society that, well, you are free and you got to work.

Well, you may want to do something on your own. I am saying that the 40 acres and a mule didn't work, and I suspect if you had given some of the generations of those entrepreneurs today 40 acres and a mule, we probably wouldn't have to have an 8(a) program today, because many of them would have sold those for large amounts of dollars and been able to finance their own efforts today.

Unfortunately, that has not been true, so I want to make it very, very clear that the 8(a) program is not a welfare program. The 8(a) program has not been a bad program. The 8(a) program has been a life blood program for a segment of the largess and developing segment of the minority economic minority community over the last 12 years, and probably what really needs to be assessed in the 8(a) program today has to do with an evaluation of the inability of the program from its own managerial and fiscal accountability to keep pace with the developing dynamics of the minority business community, and that means if they want to take a quantitative approach to this issue, they should do that by program expansion and not try to take an approach to this program by penalizing those very companies who are still very, very much in an incubatory status in terms of their growth.

They are too small to make it on their own, and the fact of the matter is in the absence of some kind of Federal partnership, they will probably fail.

[Mr. Lee's prepared statement follows:]

Prepared Statement of Rotan E. Lee, Attorney

Mr. Chairman, Members of the Subcommittee, I would initially like to express my appreciation for the opportunity to testify here today. The tone of my remarks is an admixture of urgency, hope, and a belief that the ensemble of philosophies and systems that is the framework of this democracy is still objectively rooted. Without such, any discussion concerning the unobstructed participation by Blacks and other racially ethnic minorities in the nation's socio-political and economic order becomes absurd.

The only link between that interstice of chaos and stability is an objective premise, giving rise to national and commonsensical thinking. Its absence germinates the seed of discontent where, paradoxically, the only rational recourse is irrational behavior.

"Black Economic Development" is a phraseology much encumbered by political overture, undoubtedly conceptualized to abate the fomentation of Black anger towards a nation that has refused to recognize their claims of continued second-class citizenship in an atmosphere other than one at the brink of demonstrative racial unrest. The evolution of the federal role in "Black Economic Development" has its genesis in the midst of civil disobedience and racial strife. The *Kerner* findings in the aftermath of rioting in the late 1960's disclosed that Blacks desired as much in the way of economic opportunity as they did in education and unobstructed political participation. The opportunity to participate freely in the American economic mainstream by Black Americans was never realized by the majority as fundamental to any civil rights scheme. However, what was central to the issues then, as well as now, is that equality in America has as its underpinning, an economic focus. From Booker T. Washington to Malcolm X, Blacks have historically espoused the selfsame "rugged individualism" that is redivivus in the Reagan philosophy.

The Nixon concept of "Black Capitalism" was hinged upon new born economic promises to lure Black voters from their silent contract with a political party, still reeling from the chaos that was so much a part of "The Great Society." President

Nixon literally echoed the old "bootstrap" sermon, intended to replace a welfare intoxication with the sobering reality of economic self-help. Nixon assured the Black community of a federal partnership in obtaining that objective. And, from the inception of that partnership, through two subsequent Administrations, the Black business community evidenced dynamic growth, particularly in the federal procurement marketplace. Under the aegis of the 8(a) program, an incubation process began. Though many concerns failed, some of those fledglings grew and continued to grow; today they are reasonably successful and sophisticated firms, but they are not, interestingly enough, viable and mature enough to compete solely in an unprotected market environment.

The incubation of Black enterprise under the panoply of the federal partnership is materially different from, and can be dangerously mistaken for, economic maturity. The latter requires excruciating analyses of multiple factors, which are, for the most part, quantifiable ones. According to a Task Force on Venture and Equity Capital for Small Business, appointed in July 1976 by former SBA Administrator, Mitchell P. Kobelinski, business viability is coincident with its cycle of growth in relation to the different types of capital required at each stage of its life. The Task Force's report, completed in 1977 (dubbed the "Casey Report," after its chairman, now director of the CIA), asserts that the life cycle of a new business (1975-1976 Financial Market Conditions) spans fifteen to twenty years before maturity, necessitating the redoubling of private investment efforts before the mere consideration of reaching that business pinnacle of success: "Going public!"

The "Casey Report" has gained notoriety amongst Black entrepreneurs, and it is a paramount reference in defense against the vagarious thinking of the SBA and its present leadership on the issue of business viability, the actual predicate to a determination of a company's success within the 8(a) program. Because the umber of racism often veils the credence of any analyses proffered by Blacks or assessed towards their advantage, then, perhaps (using the "Casey Report" as an example, yet, a particular reference), the SBA, if not the Administration, might be persuaded by the words and thoughts of those it holds in high esteem. I feel quite safe in challenging the SBA to produce any study, treatise, report or other analytically-based document which can defensibly support a business maturation process of from three to five years, or demonstrate why such a proposition is so contrary to more enlightened thought.

The National Association of Securities Dealers, Inc. (NASD), in its highly regarded, special report on small business financing (ref. "Report of the Joint Industry/Government Committee on Small Business Financing," May 1979) stated that:

(f)or a small business to develop, it must have an adequate supply of capital, preferably long-term capital, to help it implement its business plan, to provide it with sufficient current assets during the period that the business is being established and to provide it with the capital for growth and expansion." (Ref., p. 8, NASD, supra)

Generally speaking, the likelihood of business success is predicated upon the length of time a company is in business. it suggests that the risks associated with investment are lower. To a great extent a firm that continues successfully through the business cycle will eventually reach a point where it can generate the capital needed to support its own growth. Availability of and access to the markets for the sale of a firm's goods and/or services is an inextricably intertwined element of the business cycle. There can be no investments without markets and vice versa. There exists no substantial evidence to support an SBA, implied contention that the market/investment hurdle for the minority firm can be negotiated in three to five years without further federal support. The Agency posture here isn't logical; it waxes political.

If it can be presupposed that many Black entrepreneurs are even reasonably as capable as their majority counterparts, given varying degrees of experience, in the management and conduct of business, why has growth of Black business been measurably lesser? To answer that question, one must also accept the verity of its statement. Well, it's reasonably quantifiable through a comparison of sales; a comparison of labor and capital intensiveness; a comparison of financial participation by the commercial banking, venture capital and private investment sectors; a comparison of participation in the export marketplace; a comparison of all the factors and indicators that measure business and industrial growth in America. As a matter of fact, if one doesn't subscribe to Black Enterprise, Ebony, or the paucity of other Black periodicals, one probably would never get any ongoing sense of the trends and dynamics within the minority economic sector. I would suspect there is more information about Black enterprise disclosed within the text of congressionally-prompt record and federally generated studies than has been exposed to the public at large by the media. In fact, the media posture, as a whole, has been one of indifference or one marked by jaundiced criticism. The public perception of minority business enterprise remains an image of marginal, unsophisticated concerns, hardly worthy of much notice unless—if this dangerous political trend continues—they are led to believe that government monies are grossly misspent on programs which have little hope of success, while the program recipients grow more dependent upon federal largesse. It would not be difficult to explain to the American people that the government investment in minority business enterprise is no less a long-term investment than the public has and has had in the railroad industry, the automobile industry, the fossil fuels industry, the military weapons industry . . . the list, historically and presently, is practically endless. The cornerstone of the federal interest in any segment of the economy presumably arises from objective criteria, buffered by a philosophy that free enterprise exists only to the extent that the barriers to productivity and growth are removed. Those barriers are both external—the curbing of foreign automobile imports to help generate domestic sales; the statutorily mandated "Buy America" emphasis—and internal, as is the predicament that the minority business community finds itself when unsuccessfully attempting to enter the competitive marketplace with far lesser access to the instruments necessary for success than nonminorities. Situations of this latter nature are breeding grounds for discontent and frustration; and, when coupled with the pitch and fever of racism, the society is brought again and again to the brink of racial crisis. The Black community cannot be expected to accept less and less of intolerably smaller shares of the nation's opportunities and benefits. And, I make the distinction between an effort that is designed to placate and one that creates some basis for economic self-sufficiency.

Objective analysis implies, as part of any dialectical process, that the basic premise upon which a conclusion is drawn has some rational basis. Now, that basis cannot be essentially political, but rather one based upon precise standards and measures. The posture assumed by SBA on size standards, firm maturation, the absorptive capacity of the set-aside program . . . , in the absence of comment and analysis, flies in the face practical business reality, in addition to contravening the principles by which this federal partnership on minority economic development was established. Not once has the Agency fully acknowledged that its own programming has not kept pace with the dynamic growth of the set-aside portfolio. There is an unquestionable need for the minority business segment of the SBA to be upgraded and expanded. Contrary to much publicized opinion, the development of minority enterprise in this country has nothing to do with the establishment of a "millionaire" class of entrepreneurs. In the overall economic scheme, it is a rather collateral concern when assessed against the generation of jobs, creation of investment opportunity, participation in the foreign markets. White people don't spend much time concerned about how much money corporate owners and executives earn and what their net worth happens to be. Unless there is a defensible concern that remuneration and/or reward is an imperilment to a entity's financial stability, it is of little consequence. Profits are always had by the riskers in our economic system. And, don't think for a moment that the successful Black entrepreneurs are not emotionally and financially tied to their enterprises, nor devoid of any thoughts that their efforts are radically linked with the growth and stability of the Black community as a whole. They recognized that the moral and ethical considerations needed to insure a semblence of societal homestasis in our nation is precluded in the absence of economic parity. These owners are successful because they are competent. If that were the primary criterion for success in the competitive marketplace, they should have succeeded. But being competent, from their perspective, is a distant second to being White. I know no other way to state that fact to say it plain.

The SBA must become more accountable to the minority business community. The set-aside program should be opened and expanded, but not at the expense of penalizing those successful participants still too immature to compete without a federal partner. Entry, growth and completion phases of programming should be subject to cognizably objective measures, whim and caprice, offered and withdrawn, and, left unchecked, always capable of repetition, yet evading review.

We are all a bit too sophisticated to believe that the present SBA stance on minority enterprise is defensible. Their own purchased expertise sings a very different song. The Agency is selling politics as substance, always a dangerous precedent.

Mr. MITCHELL. Thank you very much for an excellent statement. I might just comment that I have heard this throughout my 11 years in Congress, those who have criticized the SBA and its 8(a) program in particular, and said we thought we were going in for mom and pop operations. We thought we would get people to go into little corner store businesses, and I have heard it ad nauseum really.

That is a mentality that has to be changed in the Congress and in the country. How would you respond to the argument that is raised against the Casey study, the argument being that it is fine for those firms that are involved, let's call it the Casey study, if it takes 15 to 20 years, that is all right, but we should not permit that same time span to apply to firms that are utilizing some Federal funds.

I started to call it an auspicious argument. The argument is raised that somehow or another, because Federal funds are used by some minority firms, they should not have the same length of time to move into maturity.

Respond to that argument.

Mr. LEE. I think there is a broad misconception that the minority business community that is participating in the Federal procurement marketplace is really using Federal funds from a largess standpoint. These are earned dollars. The fact that there is a restricted marketplace does not make it less competitive to the extent that they can provide a lesser quality of goods and services delivery.

If the minority business community were wholly recipients of Federal largess at all of their levels to the extent where they didn't even have a day-to-day operating control over those entities, the situation would be different. So, on the one hand, it is a misconception that there is such a thing as sort of minority business recipiency of large Federal dollars.

Second, the Federal Government has been partnered in the evaluation of certain segments of this economy for years. I think from the aircraft industry, the fossil fuels industry, and many other segments of this economy, the Federal Government has been involved in either by creating the opportunities by which these businesses could flourish or trying to create barriers by which they would be inhibited from their operation.

I used an example of the "Buy American" statute in favor of preventing the onslaught of the multilateral trade agreement, they would have made some unnecessary encouragement of the small business community, but at the same time we were talking about large business as well, because they were also in the production of automobiles and domestic aircraft and the like, so I think that the Casey study has no less validity when applied to this community that is involved in this particular protected marketplace, no lack of validity whatsoever.

Mr. MITCHELL. We witnessed over the past decade or more an increasing tendency for economic power to be concentrated in fewer and fewer firms.

I am not talking minorities now. The number of white small businesses, nonminority small businesses that have been gobbled up by the larger corporations, would not the same dynamics that caused that situation in the nonminority community be operative in the minority business community?

Mr. LEE. That possibility does exist. I think that my general answer to that is really part of the concern by many economists today in this country. What is happening today in this country is no longer an interest in the long-term investment of the Nation as a whole, but a short-term investment where the issue is to turn over as quick a dollar of profit as is necessary for an investment.

So the fact of the matter is that if you have a company that has the potential of producing over 10 or 15 years, you are probably less likely to find the same kind of investment availability for that company than you would if you had a company that had a product that was involved in a venture such as the acquisition of another company to turn over a profit in a relatively short period of time.

The development of business in and of itself and by definition is a long-term investment effort, and I think that when the Nation gets back to understanding that its productivity is actually based on long-term investment, they would find it is going to be an increasingly lesser absorption of business by those larger companies that are proliferating into literally doing everything because the issue is not productivity at a vertical level, but the object is to get a company that can do as many things as it can through as many variations as it can in order to turn over short-term investment profit.

Mr. MITCHELL. I might comment for the record that Mr. Casey has been invited to testify before this committee on June 10, and we hope that he will be able to come.

Congressman Addabbo, do you have any questions?

Mr. ADDABBO. I apologize for not being here earlier for the entire presentation, but I sit on a committee known as the "small spender," or Defense.

It has taken more time than I would like it to have taken and kept me away from my first love.

The major base of our economy is the small business community, because the small business, and even the President has admitted that small business is 80 percent of our economy, and they say that with one breath and in the other breath they take away all the aids to small business, and we turn to an important segment of the small business, the 8(a) firms which are all minority firms, not just black but many groups that are considered to be minority firms.

When we are spending a ludicrous amount of our budget, almost 60 percent of our budget for defense spending, and doing nothing to try and spread that money into the small business community, especially 8(a) firms and saddling them where we have not given them a chance to start moving and saddling them with further burdens, becomes more ludicrous in view of what is happening with the cutbacks and everything else.

I want to commend Mr. Lee and all the others who are present, because my concern, and I know the concern of the chairman, ~~is~~ that the people out there, the American public does not know what is being done to them as far as all programs are concerned, and I am happy that your 8(a) firms and organizations have kept abreast and know what is being done to them, and I wish the American people knew that.

Our senior citizens are starting to wake up as to what is going to happen to them. I sit on Defense, and I am looking at the 1982 figures, and on appropriations we have 13 subcommittees. Ninety percent of the 12 subcommittees, and the 13th is Defense, are being asked to reduce and most of those subcommittees have to do with human services, small business.

They are all being asked to cut, and one subcommittee is given all the money from those cuts, and that is Defense, so in the appropriations that we look to in 1982 we have an increase in defense spending of over $54 billion and meanwhile SBA and the small businesses are being cut down to its barest minimum and some of them are going to be eliminated as they are trying to as far as direction or indirection.

I have no question of the witness, and my only purpose for being here is in commendation for all of those who come out today to show they are alive and vigorously watching what the Government is doing and not take the rhetoric which we have lived through all these years.

I have sat as a member of this committee for 14 years, and we fought and fought hard, and the small business community out there has fought hard for a little piece of the action to try and get into the mainstream and become taxpayers instead of tax users, and I agree with the gentleman, it is not a question of anything that they were given.

They worked for it and many times they were used as patsies and they will be used as patsies again by a numbers game. What does graduation mean?

It means that you are now out of the program, go fend for yourself, and probably go bankrupt because you have not been given enough time to become part of the mainstream, and now we can show that we have helped 15 instead of 10, but meanwhile we have not helped anyone because we are bringing to the brink of disaster 10 who need a little more help.

So these things are unrealistic and like the old Indian saying, "You speak with forked tongue," this is the business we have here. So again I commend the witness and all of you who appear today, because it is a very important issue and very important segment of our economy, and if this part of our economy is hurt, our entire economy hurts and there will be no salvation, high inflation or high unemployment, especially amongst our minorities.

So, Mr. Chairman, I commend you for your continuation of bringing this problem before the public, and I apologize that I cannot be here in person but, working with you, I continue to meet with you after hours and work on this very important problem.

I thank you.

Mr. **Mitchell**. Thank you for being here, and I thank you for your statement.

I am perfectly content that you would be over there watching the appropriations for the military.

Is it to be $1 trillion in 1 year?

Mr. **Addabbo**. Next year.

Mr. **Mitchell**. Thank you very much, Mr. Lee.

You said you would try to get us copies of those two studies to be distributed to all members of the committee.

Mr. **Lee**. Yes.

Mr. **Mitchell**. Thank you for your excellent testimony.

Our next witness is Mr. Santos T. Abrilz, Jr.

TESTIMONY OF SANTOS T. ABRILZ, JR., PRESIDENT OF APOCA INDUSTRIES, INC., DEER PARK, LONG ISLAND, N.Y.

Mr. ABRILZ. Mr. Chairman, a set-aside: 5 years ago Congressman Addabbo was at a hearing where a contract was taken away from us, because we didn't have the "equipment" before the contract in order to produce the contract, and it was a peculiar situation that occurred in New York and not too many of us had the guts to come out here and testify, and we did.

It is because of Mr. Addabbo's work in rooting out the problem that I am here today.

Mr. ADDABBO. I am glad you are keeping your door open for your other friends.

Mr. ABRILZ. Mr Chairman and members of the subcommittee, good morning.

I am Santos T. Abrilz, Jr., president of Apoca Industries, Inc., Deer Park, Long Island, N.Y.

Apoca Industries, Inc. is a small electronic manufacturer specializing in the design, development, and manufacture of telecommunication equipment for both commercial and government markets.

We are 1 of approximately 30 Puerto Rican companies in the 8(a) program. Apoca Industries was established on February 4, 1974.

Our acceptance into the 8(a) program was effective November 27, 1974. Included in the acceptance of Apoca Industries, Inc. into the 8(a) program was SBA's recommendation to assist Apoca Industries for the years of 1975 and 1976 by providing support in the amounts of $735,000 and $945,000, respectively. Unfortunately, this support did not materialize.

Total sales for our company during the first 4 years ending February 28, 1975, February 28, 1976, February 28, 1977, and February 28, 1978, was $304,598. Yet we had been in the 8(a) program for all 4 of those years, and instead of approximately $1.7 million of support for 1975 and 1976, we had received a total of $200,693 in 8(a) contracts and we had approximately $100,000 in commercial contracts.

Toward the end of these 4 years, I took over the marketing and financial planning of the corporation. At the same time, we hired our first employee in April 1977. Up until that time, the employees of the company were my partner, William Carroll and myself.

At this particular juncture, we finally were able to sign an 8(a) contract for approximately $1.4 million worth of a TA-312/PT field telephone set. We had been actively pursuing this program since September 1974. This broke the logjam and over the next 3 years, we signed 8(a) contracts for the TA-838 electronic pushbutton telephone field set, the MK-693/A maintenance kit, and over 28 different types of special purpose cable assemblies for the Vinson program.

All of these programs were with the Army commands known as the U.S. Army Communications and Electronics Command and the U.S. Army Communications and Radio Development Command. In addition, we became one of two approved small business sources to manufacture the CU-350/PT impedance matching network for the Defense Electronics Supply Center.

During this period we pursued and won competitive non-8(a) contracts with Tobyhanna Army Depot for cable assemblies, U.S.

Army Armament Material Readiness Command target mechanism printed circuit boards, Defense Logistic Agency for CU-350/PT impedance matching networks, and finally with McClellan Air Force Base, Sacramento, Calif., for assorted teletypewriter components.

With respect to our pursuit of commercial sales, we have designed, developed, and manufactured a telephone system that has evolved over the past 3 years into the Investra 8000 series of telecommunication equipment. These systems have been manufactured for indepedent telephone installers and, at the present time, there are Apoca Industries, Inc. manufactured telephone systems with Merrill Lynch in Chicago, Allan & Co. in New York and the newest series, the Investra 8000 with the New England Bell Telephone Co.

We currently have telephone systems that have been manufactured for New England Bell Telephone Co., and accepted by the quality assurance function provided by Western Electric for New England Bell.

In summary, over the past 3 years, Apoca Industries, Inc., has had sales of $60,740 for year ending February 28, 1979, $755,391 for year ending February 28, 1980 and $2,024,160 for year ending February, 1981.

During this period of time, our work force of 4 employees in 1977 has grown to 26 employees in 1978, 35 in 1979, 61 in 1980 to a current work force of 86.

Apoca Industries, Inc. has generated local and State taxes of over $48,000, and Federal, FICA, and Federal unemployment insurance taxes of over $180,000 for fiscal year ending February 28, 1981.

In addition, we have generated the following dollars for goods and services over the past 2 fiscal years ending February 1980 and February 1981.

I broke up the goods and services into 2 years. For February 1980, material, we spent $566,249; February 1981, $1,297,261.

Services with respect to freight, tooling, direct and miscellaneous, direct labor, and manufacturing on OHF payroll, year ending February 1980, $517,204. In February 1981, we had $1,086,457. The combined total goods and services, February 1980, $1,083,453, and year ending February 1981, $2,383,718.

Apoca Industries, Inc., passed another milestone in its growth cycle by recording its first year-end audited statement registering a profit for the year ending February 28, 1981, as detailed in the May 28, 1981, audited statement submitted by Arthur Anderson & Co., Huntington, N.Y.

On May 9, 1980, the PP-7286/U battery charger was requested by SBA from the Electronic Research and Development Command located at Fort Monmouth, N.J. It was requested for Apoca Industries, Inc., as part of the U.S. Army pilot program.

On August 1, 1980, issue No. PSA-76746 of the U.S. Commerce Business Daily, the following information appeared under section 61, page 22.

> Battery Charger PP-7286/U
>
> This solicitation is for a 2-year, multiyear procurement, quantity of 1,015 each. Award is being made under the 8(a) pilot program to Apoca Industries, Inc., 465 Brook Avenue, Deer Park, N.Y. 11729. RFP NO. DAAK20-80-R-0557, has been assigned this solicitation. No other offers will be considered.

Apoca Industries received the solicitation dated September 12, 1980, for the battery charger. Subsequently the closing date for this solicitation was modified to January 9, 1981. Apoca Industries submitted its proposal on January 5, 1981, in two volumes totaling 493 pages.

Since that time through June 3, 1981, that was yesterday, Apoca Industries has had extensive visits from various governmental personnel, representing agencies such as SBA, DCASMA, DCAA, and ERADCOM with respect to the battery charger program.

One example was Defense Contract Audit Agency who first came to Apoca on March 11, 1981, and stayed approximately 5 weeks at Apoca Industries' facilities reviewing our proposal. An example of their audit was the material. They analyzed material quotations and prices totaling approximately $5,500,000 of material through the contract period extending out to approximately August 1984, had in fact understated its costs by $50,000, which was traced to one vendor who has submitted revised pricing.

In other words, Apoca's analysis of a very significant part of the contract had been verified as correct by an independent Government agency.

As of today, Apoca Industries has not yet received notice as to when we can sit down with representatives of the SBA and ERADCOM in order to conclude negotiations for the battery charger program.

I was advised recently by SBA personnel that there is, in fact, a possibility that SBA may decide at this point in time not to proceed with the negotiations, and that a decision would be forthcoming soon.

We are confident that this is just a misunderstanding and that we will be able to successfully enter into contract for the battery charger program in the near future, since we are well aware of the timing of products to be delivered to the armed services.

With respect to the 8(a) program itself, we are proof that the program is working with respect to the spirit of the program.

In September 1978, Apoca Industries signed a contract to manufacture special purpose cable assemblies for the Vinson program. The drawings and specifications did not provide all the necessary manufacturing and construction details. Apoca Industries successfully engineered the program, passed the first article requirements, and is presently manufacturing these cables.

We received a follow-on requirement for the cables in 1980 and at the present time, we are encountering difficulty in establishing exactly how to proceed with this known 8(a) requirement for this fiscal year ending September 1981.

There are only two approved manufacturers for these cables at the present time. In the May 26, 1981, issue of Commerce Business Daily, Apoca Industries, and another company were selected as the only approved sources that could submit proposals against this cable procurement.

I think that this action shows that companies in the 8(a) program are beginning to take those steps necessary to, in fact, become part of America's economic mainstream. But some of us are not mature enough to be abruptly dumped into this economic mainstream. We need an intelligent time-phased entry.

Here we are, an electronic manufacturing small business, staffed with a young and aggressive middle management team that is gearing up to meet our production requirements in the years ahead. Our employees represent a cross section of America.

We employ Vietnam veterans, handicapped, senior citizens, young and middle aged, some of whom happen to have been born woman, Hispanic, black, and all of them representing the various ethnic strains which in reality is one of the cornerstones of our society.

Now let's look at some facts. Apoca Industries has a current 8(a) program backlog of approximately $11.3 million. None of these programs have advance payments. With respect to business development expense, we received BDE for capital equipment only against the TA-838 pushbutton telephone contract. This business development expense is carried as a note on our financial statement stating that until such time as title to the equipment reverts to Apoca, no amounts relating to BDE will be recorded in Apoca's financial statements.

All our contracts have been researched, tracked down to specific buying centers, then working with the procuring activities, have priced out proposals, negotiated contracts, and then proceeded with implementation of these contracts.

Unfortunately, military manufacturing is an area that unless the principals involved in the 8(a) company are thoroughly familiar with Government contracting procedures, the chances for success are nil and the chances for failure are astronomical.

In order to allow the 8(a) program to meet its objectives, there must be the following:

One, establishment of a strong, middle management team in the particular company.

Two, multiyear manufacturing of a particular product in order to establish hard tooling, decrease employee learning curve, and increase productivity.

Three, group companies into two tiers. One tier noncompetitive among 8(a) companies; second tier competitive among 8(a) companies.

Four, graduation of companies who have met the stated criteria for graduation from either first tier or second tier objectives as defined by SBA.

I do not presume to be a wise man and say that it is because of this reason or that reason why the 8(a) program has been abused and misused by elements of both private and public sector.

I can categorically state that our company with all it has achieved to date could never have come this far without the vehicle entitled section 8(a) of the Small Business Act and the hard work of all of us at Apoca.

After all, when you get right down to numbers, the gross sales of the top 100 black businesses listed by Black Enterprise magazine, and the top 100 Hispanic businesses listed by Nuestro magazine, would not equal the gross sales of one Fortune 500 company in the middle 200 range.

I say cure the abuses, define and negotiate graduation criteria for all of the present 8(a) companies in the portfolio.

In conclusion, I would like to ask where are we going to find the competitive new products to break the inflationary-prone grip of a few individual companies on markets in industry, after industry, especially my industry, telecommunications, Ma Bell, as you can see, is a tremendous competitor, if not in places where America has always found them before, outside the industry affected, in independent small firms with no vested interest in existing technology.

There will be no free enterprise system for large business unless we quickly find a way to restore strong, viable, and competitive small businesses across this Nation.

Mr. Chairman, this completes my statement. I have appreciated this opportunity to give the subcommittee the views of one small business on such an important subject.

I will be pleased to answer any questions you may have with respect to my statements.

Mr. MITCHELL. Thank you very much for your statement, and thank you for a success story.

Suppose you were graduated from the 8(a) program as of September 1, how would you fare?

Mr. ABRILZ. You would think that I would be doing very well, but the answer is negative.

Mr. MITCHELL. Why?

Mr. ABRILZ. The first couple of years that we operated we had very few sales but we had expenses, so we have to carry forward losses through to this year. You can't go to a bank with a statement that does not show a net profit.

Even today, the fact that we don't have advance payment is forcing us to get supplies from vendors on a c.o.d. basis. Our cash flow is constantly in a hurting position because of the fact that there are times when a shipment comes in that we really don't have the dollars to make that shipment.

We have to then scrounge to make payroll for the following week, et cetera, et cetera. We can't go to the bank to get a loan because of the fact that our statement does not show a profit. We are not, well, we have only started growing the last 2 years to speak of, so we can't get the line of credit needed in order to establish good material income in order to ship the products out in a timely fashion.

Mr. MITCHELL. You would show a profit if you were allowed to show your advanced payment?

Mr. ABRILZ. No; I am saying that because of the fact that we can't pay for material on a credit basis the way other companies do, we have to pay for it up front, so that is an up-front cost that is over and above what everybody else does in public mainstream.

Mr. MITCHELL. Suppose the Administrator of SBA issued a directive saying as of June 1, this year, none of the presently identified 8(a) firms that have contracts would be entitled to any further contracts.

What kind of impact would that have on your business?

Mr. ABRILZ. I would say we would close down within, or as soon as we shipped, probably a definite date, by around September 1982, because that is the last cable contract we have. In other words, all we could do is wipe out the current backlogs we have in the house.

You ask why? Why can't we compete after other contracts in the military market? I will tell you why.

In order for us to compete in the military market, there is a survey called the "Pre-Awards Survey" and you have to be capable of financing the program. If we were to go ahead and win the program, normally we carry about $800,000, $900,000 worth of material costs to take care of.

That material cost would have to be financed out of some kind of private payments which only account for 85 percent of the material costs, so 15 percent of the costs would have to be financed by us, and the only way to do that is out of previous profits from previous contracts.

We would be unable to do that, therefore, we would be turned down, even though we have the capability to perform under the program. The reason the 8(a) program is so critical with us turning the corner this year, it won't take much longer for us to turn the corner, but the question is, is it 1 year, 2 years, or 3 years?

If you take that attitude that the Administrator took, that arbitrary 4 to 6 years is the correct figure, we should have been graduated when we had $755,000 worth of sales, and if we would have been out of the program we wouldn't have been able to make this year and the Government right now would not have a qualified source, one of two in America, for some 28 different types of cable programs, and the Government would not have the only source for the TA-312 telephone, and the Government would not have its only source for the new electronic pushbutton field telephone set.

Mr. **Mitchell**. Congressman Addabbo?

Mr. **Addabbo**. The source would then probably be developed by one of the majors, and then we would——

Mr. **Abrilz**. For the TA-328, it would be ITT North. For the TA-312 it would be Western Electric, and for the battery charger it would be RCA.

There would be absolutely no competition.

Mr. **Addabbo**. We in the Defense Department have seen what happens with sole source and we can see what happens with defense spending, so you actually being there as a competitor keeps their feet to the fire and keeps them honest.

Mr. **Abrilz**. We have saved the Government hundreds of thousands of dollars in the cable program alone.

Mr. **Mitchell**. Mr. Hiler?

Mr. **Hiler**. You mentioned a great many problems about cash flow, c.o.d., and a number of things that are inherent with all small business. I have a tremendous number of small businessmen in my area, people in homebuilding, recreational vehicle, manufactured housing, machine shops. Many people that go out of business and in fact the failure rate of small businesses is phenomenal.

Somebody said God must love the small businessmen because he created so many of them, and there are always so many of them around, and I think that is true. In rationalizing why a particular phase-in program is needed or not, why do you feel you should be different than the other 2 million small businesses that start up every year?

Mr. **Abrilz.** I would hate to make the Congressman's displeasure at this point, but look at it from my viewpoint.

Try and take a taxi outside this place, New York City, Chicago, anywhere, who do you think will get the taxi first?

I am serious. I said don't take displeasure. I am telling you that we are not born equal in this country; we are not.

The moment our colored skin goes into consideration, there is the subconscious differentiation between what we are and what we are capable and competent of doing.

For that reason we have ghettos throughout this Nation, and we don't have businesses going to the ghettos and providing jobs. In my area, four or five areas, all my employees come from those areas. I have people who couldn't get a job. Why? Because if they ask for a job, three of them go for a job, and you know who will be hired.

I don't care what is said in terms of laws, procedures, and I am talking practical, day-to-day facts, 30 percent of our country is minority.

The only thing that we have to show, the only thing we have to show in terms of economic viability is our 8(a) companies, plus maybe another 1,000, 2,000 out there.

Numbers have quoted 72,000 minority small businesses in the South. Out of 72,000 how many are manufacturers employing more than 10, 15 people?

Mr. **Hiler.** How many small businesses employ more than 10, 15, or 20 people when you take into account all of the 16 million small businesses we have in the country?

Mr. **Abrilz.** If small businesses should withdraw from the major industry, such as telecommunciations, et cetera, and remain 10- to 20-man shops and not go over, where do you think you will get the future ITT's and General Motors from this country?

Mr. **Hiler.** You don't have to tell me about the merits of small business. I come from one that my grandfather started after he retired in 1946. He went out of business three times before he made that one successful.

What I am getting at, one of the critical things here in what the new Administrator of SBA has proposed, and it is something that this committee has been considering a great deal, is this phasein process. You call for an orderly phasein. I don't think anyone would disagree with the need for an orderly phasein. But, how do you determine an orderly phasein? When do you determine that a business should be able to stand on its own?

I am saying that I have tremendous numbers of businesses in my area that fail for the same reasons that you potentially could fail if there were not an 8(a), wondering why you should get to keep it?

Only 4 percent of any businesses that have gone into the 8(a) program have ever been graduated.

How would you design a phasein program to bring more businesses into 8(a) and move them out and increase the number of minority enterprises that we have in this country?

We are all interested in that.

Mr. **Abrilz.** Congressman, phasein, phaseout graduation has nothing to do with the fact that my company is in 8(a) and another company is in the DOD contracting area, when there is no difference between the two of us, the 8(a) program has done absolutely nothing for us that is not being done right now with respect to negotiated procurements.

Over 70 percent of DOD procurement are negotiated, so all the Government has done is identify a particular procurement as a negotiated procurement instead of two sources for a single-course. They have said this is going to be a single-source negotiated procurement.

From that point on, forget we are minority. We have to go through the same procedure everybody else has to, so there is no giveaway.

Mr. HILER. What I am talking about——

Mr. ABRILZ. All I am saying is if it wasn't for the 8(a) program, I couldn't get the contracts.

Mr. HILER. How do we get more people into the program, given the fact that the same piece of pie is being taken by the same people year in and year out?

Mr. ABRILZ. You see, you are saying we want to stay in the program forever. We don't. I want to see established orderly procedures. What are they? Obviously you should be reasonably profitable. You can't say that they graduate after a certain amount of time. You should have some kind of guidelines as to whether you should maintain given work to an 8(a) company.

I agree there are 8(a) companies in our midst who should never have started in the first place who are really hurting us. I am saying if the SBA would institute rules, specifically rules——

Mr. HILER. SBA just introduced specific rules.

Mr. ABRILZ. Just introduced after 12 years. Do you understand what I am saying?

Mr. HILER. I understand exactly what you are saying. You are disagreeing with the specific rules. What would your rules be?

Mr. ABRILZ. I am not disagreeing with the rules. They were just published June 1.

Mr. HILER. Their rules, as I understand it, call for a phasein, a definite 3- or 5-year phasein; is that correct, Mr. Chairman?

Mr. MITCHELL. Generally correct, yes.

Mr. HILER. It is set to phase in with the passage of time.

Mr. ABRILZ. That is fine with new companies. What are you going to do with old companies? You should negotiate separate agreements with the old ones. If a guy is successful and has that profit for 5 years in a row, graduate, with knowledge of what industry he is in.

There are some industries that are very—they are not people intensive, they are material intensive or something intensive. You have to use judgment on a case-by-case basis.

I am saying if what you are saying, 3 to 5 years, 4 to 6 years for the new, that figure should be looked at. It should be looked at with respect to the Casey report. If Casey is saying it takes 10 to 15 years to mature a company, for Christ sake, use the same rules and regulations with respect to how long an 8(a) company should be supplied.

If you can't have 2 million minority small businesses, then have 2,000 minority businesses or 1,000. The number doesn't matter, so long as the small businesses, when they graduate, are going to be able to keep on producing, have effective lines of credit and can perform within—with parity. We don't have parity.

Mr. **Daub**. The figures which you had in the report which you read, which we all could read, is $2 million your current size in gross income or gross billings?

Mr. **Abrilz**. Gross billings for last year.

Mr. **Daub**. What is the percentage in that $2 million split between 8(a) and non-8(a)?

Mr. **Abrilz**. I would say $1.7 million.

Mr. **Daub**. To $300,000?

Mr. **Abrilz**. Yes.

Mr. **Daub**. What is the percentage of total Government to non-government-related contracts?

Mr. **Abrilz**. Obviously, on the commercial telephone market, it would not be Government.

Mr. **Daub**. Is that the $300,000 then?

Mr. **Abrilz**. Not quite. We are just starting.

Mr. **Daub**. The current $2 million in your last column?

Mr. **Abrilz**. The $300,000 would be part of the commercial. There would be also competitive bids. That is still Government, but not 8(a).

Mr. **Daub**. Of the $1.7 million, how many are 8(a)?

Mr. **Abrilz**. That is all 8(a). Remember, we have backlog of $11 million worth of contracts. So any percentage of commercial work is insignificant to that number.

Mr. **Daub**. Does any of the information here list any of your successful competitive bids?

Mr. **Abrilz**. Yes.

Mr. **Daub**. Were any of these things successfully competitively bid?

Mr. **Abrilz**. Yes.

Mr. **Daub**. Which ones?

Mr. **Abrilz**. Let me think.

C. & P. matching network, which is where we are only one of two qualified suppliers in the country. Print circuit board for Darcon. Teletypewriter parts for California. The adapter mechanism for the A-15 for the Navy, bomb adapter mechanism. We obviously, and distribute our resources, we don't have competitive bids. When we have enough 8(a) work that requires planning over a 3-year period——

Mr. **Daub**. If we cut the Defense Department budget, that might hurt your business, too.

Mr. **Abrilz**. Not particularly. We might go after the medium-size contracts and wipe them out that way.

Mr. **Daub**. The only way you can grow is to have more to do.

Mr. **Abrilz**. As a manufacturer, you are correct. You can grow or go under.

Mr. **Daub**. You don't have an advertising budget. You don't have to market with television and advertising so much as a lot of other companies.

Mr. **Abrilz**. No. I have to go visit the various commands and find out what kind of programs are coming up. Then speak to the engineers and find out if we can't get part of that package so we can be part of the bidding process. That takes money.

Mr. **Daub**. Let me give you a little bit of the philosophical point of view on my part from what I consider to be an implied racist statement.

I am a member of the NAACP and Urban League, and I am white. I live in Omaha, Nebr., which has a minority population of 42,000. My wife is minority. I am very concerned about who steps over a curb in Washington, D.C., or Omaha, Nebr., and your hometown and who gets a cab first, too, as much as I am knowledgeable of who drives that cab.

I think it is important for you to understand that I listened to your statement. I want you to know something. I think you have been highly successful by virtue of the 8(a) program, and I am proud of that because I support the 8(a) program.

But I can tell you across this country there are a lot of other stories that aren't being told here today that place that whole program in jeopardy.

You appreciate that the reason this chairman, my colleague has convened these hearings is not so much to condemn the program as to find out what we can do to improve upon it. If we don't get rid of some of the abuses in the program, really take what I say to heart, then success stories such as yours will not be repeated. I am proud of you, but there are a lot of abuses in the program. If we don't figure some mechanisms of graduation, termination, of competitive bidding within the 8(a) program, then there are enough critics of this program that, regardless of Parren or my conviction that it should continue, to eliminate it.

What we are looking for from our witnesses is not so much the success story, but what you tell us that we can do to make it a better program.

Mr. **Abrilz**. You can stop having so many hearings with the Administrator and tell the Administrator to issue specific guidelines on 8(a), what specific procedures in the standard operating procedure defines graduation by industry. Not just across the board, because service industry versus manufacturing is two different histories.

You really have to come up with a concentrated program——

Mr. **Daub**. Do you think it was too hard for you to get certified? It looks like you got certified very quickly, from the first page of your testimony.

Mr. **Abrilz**. Nine months. I incorporated February 4, 1974, and didn't get certified until November.

Mr. **Daub**. Is that a problem?

Mr. **Abrilz**. Yes.

Mr. **Daub**. How do we streamline this?

Mr. **Abrilz**. You are asking for a complete overhaul of the 8(a) program. Once you meet us, find our problems and give that to the Administrator——

Mr. **Daub**. Accept my premise that I support the program. I am trying to learn technically what we might do to advise the Administrator of a method which might make it more viable.

Mr. **Abrilz**. Why don't we go into one room some day off the record, 10 Congressmen, 10 SBA people, 10 8(a) contractors, and say this is what you have to do to correct it.

Mr. **Daub**. Let me tell you I have got a lot of minority contractors in my hometown that are ticked off because they can't get $1 worth of 8(a) set aside.

Mr. **Abrilz**. Understandably ticked off.

Mr. **Daub**. No doubt about it. So I have got some contractors in my town who have gotten $20 million worth of contracts under 8(a).

Mr. **Abrilz**. So whose fault is that?

Mr. **Daub**. I think there is politics.

Mr. **Abrilz**. It is not the contractors' fault. All we do is fight for programs. It is up to the administration of the program. It is up to them to issue the guidelines. It is up to them to issue who gets and who doesn't get. It is up to them to have panels that select corporations based on their competence.

Mr. **Daub**. Then you agree no one should get in before they agree to a termination date?

Mr. **Abrilz**. Absolutely.

Mr. **Daub**. In relation to their industry, in relation to their labor intensiveness?

Mr. **Abrilz**. When you sign that business plan, you go in there and know when you are going to graduate, then you plan on it.

Mr. **Daub**. What if you fail to file the annual report? Should you be bounced from the program?

Mr. **Abrilz**. What annual report?

Mr. **Daub**. There is an annual report required from every certified contractor, a business report, a profit and loss statement of your own business. If you fail to file——

Mr. **Abrilz**. I file that on a quarterly basis.

Mr. **Daub**. If you fail to file the annual, should you be bounced from the program?

Mr. **Abrilz**. If that is part of the requirement, yes. Not just all of a sudden they found they haven't requested a report for 5 years and now there is a rule that says you must file a report and they use that as an excuse to bounce you.

Mr. **Daub**. That has been part of the rule a long time.

Mr. **Abrilz**. I know. But have they exercised that rule? Have they asked all the 8(a) contractors on an annual basis, "We need a copy of your report"?

Mr. **Daub**. I am fully willing to accept any reasonable standard of those kinds of oversight on the part of the SBA. I can tell you right now, sitting on the Government Operations Committee where my colleague, John Conyers, and I held hearings in Detroit on 8(a) oversight to find out why SBA wasn't doing their part to make it work, that your criticism is well aimed.

I am just asking if you agree, that SBA should bounce them if they don't comply with rules they knew about.

Mr. **Abrilz**. Exactly. I am saying establish rules. Meet with all of us. Tell us about the rules and then we can go from there.

Mr. **Daub**. One last question: Where did you find out about the 8(a) program? Can you remember how you first found out about it?

Mr. **Abrilz**. Sure can. I worked as an employee for one of the first 8(a) companies in Brooklyn, N.Y., in 1970. I said, "As No. 2 man, if I can do it for somebody else, I can do it for myself."

Mr. **Daub**. Free enterprise.

Mr. MITCHELL. The gentleman's time has expired.

Thank you very much for your testimony.

Mr. ABRILZ. Thank you.

Mr. MITCHELL. We appreciate your participation.

Our next witness is Ms. Louise Woerner, president of HomeCall of Rochester.

TESTIMONY OF LOUISE WOERNER, PRESIDENT, HOMECALL OF ROCHESTER, INC.

Ms. WOERNER. Thank you, Mr. Chairman.

Mr. Chairman, that seems like a rather tough exchange to be following. I have seen some of the experts here today say they have a statement they would like to submit. I have one also. So, if I may, I submit that. Then, if from fear or something, I fumble up the statement, the record would be straight. Thank you, I would appreciate it.

I am Louise Woerner, as you have mentioned, president and sole owner of HomeCall of Rochester, Inc., a New York corporation which sells home care services, management and financial analysis, training and research.

I have worked in small business for 18 years and have owned my own small business for 3. I have an MBA from the University of Chicago. I was named Woman of the Year in 1980 by the Texas Federation of Business and Professional Women's Clubs of District 15. On December 12, 1980, after over a year's struggle to get the rules changed, coming after a long unsuccessful struggle to get in the program in the first place, I became the first white woman certified socially disadvantaged under the interim rule for section 8(a) of the Small Business Act.

You may be wondering why I am here today. One of your counsel who discussed my case and SBA management assistance with me in advance said that what my company really needs is a hot-shot MBA from a good school. What I would like to tell you is that I am a hot-shot MBA, and it really just hasn't been enough. The section 8(a) program of the Small Business Act is what is needed by disadvantaged small businesses, especially those owned by women. I hope today we can sensitize you, Mr. Chairman, and possibly Mr. Addabbo, that the 8(a) program is a program for disadvantaged, not only for minorities, because I feel like a real minority in the group today.

I have been more or less solely responsible for myself from a early age. Along with most other working women. I work because I need the money.

I earned a bachelor's degree in business administration from Trinity University in San Antonio in 1964. I worked my way through school as a secretary in the business department; had tuition, room and board scholarships; edited the yearbook and the literary magazine which paid a stipend; and held part-time jobs as a bookkeeper, switchboard operator, and babysitter. Yet, when I graduated at the top of my business class, after doing all that, I was still unable to get anything higher than a secretary's job.

My male classmates had no such problem. This was my first bruising encounter with social disadvantage.

I decided to get another credential, because that is what is supposed to help you. Harvard's MBA program, at that time, was closed to women. That is another social disadvantage. I did get into a Chicago MBA program and I was the only woman in my class. Again I had to hold several part-time jobs and borrowed under the National Defense Education Act. I am proud to say it took me 10 years but I paid back every penny. I worked very hard in that school and did relatively well.

The placement department at Chicago is thought to be the best in the country. Yet they were only able to get me what they called a marketing job. That was a job where I would be demonstrating refrigerators. Anyway, I wasn't willing to take that kind of job.

My male classmates were getting good jobs in the so-called top consulting firms in New York, the best known management firms in the country. I decided I wanted to continue to work hard and try to get that kind of position. I went to a smaller research company in Dallas, Tex., at far less salary than my male classmates and I had to do research as well as keep the books for the company.

These career problems have persisted. Although I have always done outstanding work, but have gotten second-rate pay and rewards, if I was able to get the job at all. After 3 years of proving myself in consulting, I went back to a firm where my male classmates were hired right after school. I took more tests and interviews. They said I had done exceptionally well, but finally decided that their firm simply wasn't ready to hire a woman.

That really got me because I really hadn't applied there to be a woman. I applied there to be a professional consultant and I was very disappointed not to be hired. I don't want you to think that I have a hangup about being a woman. I really don't, but I don't have any experience being anything else. That is a social disadvantage again.

In 1978, I decided to set up my own firm to gain control of my fate. I went to Rochester, N.Y., because of the encouragement of Dr. Doris E. Hanson—president of HomeCall, Inc.—a small business owner and expert in home care, and because it was my hometown, so I had long-time friends in the city's business, financial, and legal establishment. Because I was a native of Rochester and had friends, I had every reason to believe I would get ahead.

I had a lot of experience in health care, I had an MBA and a home that I could use as collateral. Even with that, I was turned down for a $10,000 loan from a Rochester bank to which I had been recommended by male professional friends. By this time, it was no surprise to me that a 21-year-old male friend, who was a friend of a friend of mine, without comparable education, experience, or collateral, got a loan of more than $10,000 from the same bank the very day after my loan was denied. Social disadvantage compounded.

I used my Master Charge card to buy office furniture because I was determined to go ahead. There was too much at stake to quit. Just ego on the line, I guess. I opened an account at the bank, hoping to get a loan later when we had what they said I was missing—a track record.

After a years time, I went back and tried to pledge my accounting receivables as collateral. I was shocked when the bank officer asked me if my father would be willing to cosign the note for me.

Apparently, the bank didn't care that I was a hot-shot MBA who now had a track record. I told them my father had been retired for 10 years and I really couldn't ask him anyway.

Then the banker asked if my manager, Mr. Lee VandenBos, would cosign the note. When I told him that Lee VandenBos was not a mister, but a 23-year-old woman, he totally lost interest. Double social disadvantage. And remember, this was in 1980 and there were laws, not only against this type of discrimination, but also laws that encouraged banks to make loans to businesses which increase employment in the community. When I applied for the loan, I was employing over 30 home care aides and four professionals.

I filed a complaint with the Comptroller of the Currency, but the trouble went on. The Comptroller addressed me as "Mr. Louis Woerner" in their correspondence many times. They quickly dismissed the complaint after they called the bank which assured them that they hadn't done anything wrong. I appealed but got no satisfaction. I finally talked to one woman investigator, who mentioned to me in confidence that I was regarded as a raving feminist nut by her male colleagues. Social disadvantages can thwart your best efforts, no matter how well educated or experienced you are, or how hard you work to succeed. If your education and work don't get you, the stigma of being a raving feminist will.

The problems continued. Since I began my own firm, I have not received a single Federal contract, despite many proposals. I was really surprised about this because I had 8 years of experience as a project manager of Federal consulting contracts for a male-owned firm in Washington, D.C. I was known in the Federal system as a management person in a good company, so I had every reason to believe I was going to do very well. Once I got out from under this protective male umbrella, however, I was out in the cold. Social disadvantage again.

In 1979, I began an effort to obtain an 8(a) certification. There were no rules to follow to prove your case as an "other" in the 8(a) system. My application was denied, giving no reason except that I was not socially disadvantaged. I appealed and fought hard to make SBA specify what was required to establish a case of social disadvantage. I have been told that the interim rule passed on December 1, 1980, was at least partly because of my efforts and at least partly based on the format of my appeal.

On December 12, 1980, I was certified 8(a).

I anticipate this certification will help me successfully bid on contracts for Federal research and management studies and training that I have not been able to win through open competition. I would like to note, as have some of the others here today, that 8(a) is not a welfare program. It is an opportunity program that enables disadvantaged firms such as my own to get in the door to compete. The Federal Government is the Nation's largest purchaser. Small, disadvantaged firms, although known to be innovative and to create jobs, simply cannot compete without some assistance, until they become known.

Through 8(a), I can probably get a corporate track record. As most of you know, Federal contracts are based on corporate experience and staff experience in Federal work. This weighting, along with lack of resources to use on marketing and proposal writing, which costs about $2,000 or $3,000 a proposal makes it virtually impossible for new or outside firms to win competitive contracts. The 8(a) set-aside should give my firm a chance to get the experience we need to compete.

It would be unfortunate if Congress backed away from one of the new Federal programs that enables small, disadvantaged business to get on their feet, especially since the Supreme Court just upheld the legality of this approach.

In the *Fullilove* v. *Klutznick* decision, July 2, 1980, the Supreme Court ruled that Congress can establish quotas to remedy past discrimination and to avoid present discrimination. This is a remedial power you can exercise to place disadvantaged persons on a more equitable footing. The 8(a) program does exactly just that.

While *Fullilove* addresses minority firms, women-owned firms face forbidding, if different barriers. For example, I doubt if a minority male contractor has been asked to have his father cosign a note or asked if he wanted the contract enough to go to bed with the Federal officer. I have faced both problems.

We all know the 8(a) program isn't perfect, but it has worked. And I have more confidence in its potential than ever because I believe the Reagan administration and the new SBA administrator, Michael Cardenas, can resolve the problems that exist and move the program forward.

There has been progress made by the Small Business Administration in correcting the problems that first plagued the 8(a) program, including the thorny question of how to determine who is socially disadvantaged. This is one area where SBA has moved forward and solved the problem.

The interim rule of December 1, which set out a case-by-case method to evaluate social disadvantage, agrees with the April 1981, General Accounting Office recommendation that small business programs such as 8(a) should be open to women.

Strong congressional advocates of the 8(a) program had said that 8(a) should exclude women because the 8(a) pie was too small to divide between women and minority-owned firms.

We have heard discussions today about the pie problem. It has been said in the past that there should be separate programs for women. I did look into the idea of separate programs and found that the ones started at that time had no money, no staff, and most importantly had no contracting mechanism. At this point, even the sham programs that existed for women have been abolished altogether. I therefore opposed even my own professional organization so that disadvantaged white women could get into the 8(a) program.

My concern today is that the real problem confronting this committee is not whether or not there are a lot of small issues plaguing in the program. The real question is whether or not a set-aside program should be in existence at all. The real issue is not whether the program has been used for political purposes. It is not the fact that there have been abuses. It is not the fact that there are size standards that might be needed. It is not the fact that possibly we should be concerned about the number of years a firm stays in the program.

The real issue we are grappling with is whether or not the 8(a) set-aside is valid at all. My answer is, yes, we definitely need a set-aside program. It is an excellent program to help companies that have enough expertise and capability to be successful, but because of disadvantage, can't otherwise get in. With the help of the 8(a) program, we should be able to gain entrance and to gain a track record so we can later compete with our major rivals who now dominate virtually all of the Federal business.

Why is this important? I would like to give you my case again as an example. My firm now employes over 70 home care aides, and we have 9 professional staff members. Many of these aides were unemployed before they went to work for us. Many were what are called hardcore unemployed, teenagers, and young adults who were unable to get a job. Others were displaced homemakers. Half are minorities; half are women.

With my background and previous consulting experience and with the training and consulting expertise of my professional staff, we have developed a process for selecting, training, and hiring such persons. We have been more successful in training and placing them than of the Federal Government in its Comprehensive Education and Training Act or other Federal programs. This is innovative entrepreneurship and it comes from small disadvantaged firms who have direct experience in our fields.

My major product is the delivery of home care services. This is a viable but still evolving option to the very expensive institutional health care. Institutional health care is not only terrifically expensive, but offers an uneven quality of care.

Our firm has helped Monroe County, N.Y., keep social services and health services costs down. This is a very important contribution for such a small firm. It came about only because the county social services leadership was willing to try an unproven firm.

But the Federal Government has not been willing to try an unproven firm, even though now we have a track record at the county level. My company does contribute. We have approaches and methods that work and we think that they can be incorporated into Federal policy and planning.

The 8(a) certification will help us get in the door and compete against entrenched institutions who have never done direct delivery as we have, but make their recommendations based simply on theory.

Today, large institutions are the Federal Government's source of ideas on training, evaluation, and planning. Not only jobs for the difficult to employ, but also in the critical areas of the health and social services. These companies that are doing this work have no direct delivery experience. Our small disadvantaged firm does.

I hope that a year from now my 8(a) firm will have such contracts as the "Evaluation In-Home Services" on which we recently bid. We can do highly professional work that can help ground Federal programs in reality. I can assure you, as can anyone in it, that the small business person really knows about management and really knows about cost containment. Other 8(a) firms have as much to offer as our firm does.

We need your help to assure this program continues. The 8(a) program is not an entitlement program. It is an opportunity program. Many of us are eager to grasp that opportunity. We do not have to be concerned about the size of the pie. There are billions of Federal contracts out there. If 8(a) can help us, we can get in the door to compete.

I support—hope that you will support—the program despite its faults, and I call on the SBA Administrator, Michael Cardenas, to improve the program's management so it can achieve its potential.

Thank you.

Mr. **Mitchell**. Thank you very much for your testimony.

I might just comment that, in the past, there have been billions of dollars out there. But with the new austerity being imposed on us, there might not be next year except in defense.

You have your 8(a) certification but no contracts?

Ms. **Woerner**. Yes, sir.

Mr. **Mitchell**. How many times have you bid on Federal contracts?

Ms. **Woerner**. I haven't bid as an 8(a) contractor. I have bid on contracts competitively.

Mr. **Mitchell**. Competitively?

Ms. **Woerner**. Yes, sir. And I have not been awarded a competitive contract. As you know, the climate has not been the best, since I was certified in December. There have not been a lot of 8(a) contracts since then to anyone. We have several we are developing. I would expect, in the next few months, we will be able to get some.

Mr. **Mitchell**. Has your 8(a) certification served you in any positive manner?

Ms. **Woerner**. It has opened the doors that were totally closed to me when I was trying to do it competitively.

Mr. **Mitchell**. Did it, for example, facilitate your involvement with Monroe County?

Ms. **Woerner**. No. That is a State contract. I was able to get that on my own. I guess what I am saying is that we have recently come into the program, and I have been able to do some marketing here in Washington, kind of carrying forth my package of expertise. I wasn't able to get in the door on a competitive basis. The big institutions who control this business simply control it.

Now, with an 8(a) certification, in the last few months, I have been able to get in. I think we are going to do well. I mean, I have confidence that things are coming forward in the next couple of months which we will be awarded competitively. It is very hard work, as the gentleman over there has indicated, to get in the market your services even with an 8(a) certification. It is not a free ride. But I think I can be successful. I feel that I will be successful.

Mr. **Mitchell**. Thank you.

Mr. Hiler?

Mr. **Hiler**. Thank you, Mr. Chairman.

Being a 1977 University Chicago MBA graduate, I would like to say that I think it has changed dramatically. You might find substantially more women there and substantially higher salaries.

Ms. **Woerner**. Mr. Hiler, you might just look back, just a couple of days ago there was an MBA article in the Wall Street Journal, I believe, on women——

Mr. HILER. I know how you go about getting the interviews for the jobs. How long have you had your business?

Ms. WOERNER. I started my business in June 1978.

Mr. HILER. Are you profitable?

Ms. WOERNER. Yes, sir. Not big piles of profit. We are——

Mr. HILER. You are making a profit?

Ms. WOERNER. Yes, sir.

Mr. HILER. Why do you think you should be part of the 8(a) program if it is to help businesses just getting started, if one of the purposes is to help people that aren't profitable?

Ms. WOERNER. I don't think that is the purpose of the 8(a) program. The purpose of the 8(a) program is to stimulate competition for Federal programs, for Federal contracts.

Mr. HILER. Isn't it to help disadvantaged businesses?

Ms. WOERNER. I think it is to help disadvantaged business be able to compete for Federal contracts. It is not to help grocery stores. Every disadvantaged business will not be able to do business with the Federal Government, I don't think.

Mr. HILER. Right. Well, the witness before you mentioned that one of the criteria he would use to determine whether somebody would be graduated out is profitability.

If you start with businesses getting into 8(a) contracts that are already profitable, what kind of criteria would you use to graduate out? In fact, you just got in the program, how long do you think you should be in it? What criteria would you use for yourself?

Ms. WOERNER. I think you need to look at the industry's size. I think to be in the program long enough to be able to compete. When I am out of the program or when I move from 8(a) to small business to whatever through some kind of a system. I should be able to be competitive with the Upjohns of the world who do the business now.

You are trying to foster competition, so that the Federal Government can get better products and have a competitive price, and we are also trying to foster competition.

Mr. HILER. Well said. You said in your statement was that the real question here today is whether there should be contracts set aside to correct past disadvantage that may have taken place. Is the purpose to promote competition in all the Federal Government, or promote the rectification of past discrimination?

When you are wrestling with how to determine who should come in and how they should get out, it would seem to me that profitability should be one of the things to look at. Do you have a viable business?

Ms. WOERNER. Yes, sir, I do.

Mr. HILER. Viable, even if you had never gotten into the 8(a). Of course, you have not gotten any contracts.

Ms. WOERNER. I have a small disadvantaged business, but what I tried to say in my testimony and I am sorry if I did not make it clear, was that our company has things to offer to the Federal Government in the areas of social services and health care delivery that can be very effective mechanisms in areas in which the Government has not been successful using theoretical approaches developed by companies that never do work in the field. The reason we want to do Federal Government work is because we think we have a product that is very favorable to the Federal Government, that will benefit the Federal Government and that is just you and me, and that will benefit all the American people, and do it at a competitive price. So we may be a firm which can't get into the Federal programs or into the system, but we think if we can, we have something to offer that will be good.

I wasn't a Congressman, so I didn't draft the 8(a) legislation, but I think the goal of the program is to help companies who have something to offer, who can do a good job, and who can present that work at a price that would be favorable, to compete with companies that have been doing it for a long time, and have really closed out any new competition. It is kind of like handicapping in golfing. If you didn't give some golfers a handicap, the pros would never have anyone to play with.

That is what we are really talking about here.

Mr. HILER. Thank you very much.

Mr. MITCHELL. I heard an exchange there, and I think it is important to clear up my position on this.

I do not believe that the 8(a) program is necessarily designed to protect against past discrimination solely. It is designed to protect against ongoing present discrimination as well.

I think this was brought out very ably in your testimony, just as it has occurred in your case, we have minorities, Hispanics and others who are still facing rather systemic discrimination.

Mr. HILER. I understand that, Mr. Chairman, and I did not mean to imply that that was not part of the 8(a) program.

What I was having difficulty understanding, is whether the 8(a) program is designed to help correct for past discrimination or ongoing discrimination to businesses that are not able to survive because of it. If a profitability type measure is not looked at as an indication of viability, how do we ever graduate somebody out?

To say that graduation should come only when you get competitive with Upjohn means you could be in the program for 30 years, and maybe you should be. What I am saying is, if that is the case, that is going to limit the number of other people who can come into the program.

Ms. WOERNER. Let me question the issue of why, why does anyone think that there are only *x* number of people who can be in the program? I don't really understand that.

Mr. HILER. The dollars that are set aside limits the number of firms.

Ms. WOERNER. How it really works is not how you think it works. The idea that something is a set-aside is really not true. Somebody like me goes knocking on the door to somebody, a contracting officer or Federal technical officer, and I say, we have this product and we can do it this way and you have been doing business with Upjohn, and I think that we can do it otherwise and they say, "How can we do it?" and so forth, and you say, "The 8(a) contracting mechanism will allow you to do that easily."

We won't be able to compete on the street. If you issue this in a RFP on the street, we don't have $40,000 to put into writing a proposal. By using the 8(a) set-aside, well, it probably wouldn't cost that much, maybe about $10,000 to write a proposal. But by using the 8(a) set-aside mechanism, you don't have to go on the street to force us to write that expensive proposal which we couldn't do, and you will give us a chance to try and see if we do have something to offer.

That is really how the program works. You have to knock on the doors and sell your capabilities. You see, there isn't the big set-aside thing in the world that falls down on you from the sky. It just does not happen that way.

Mr. DAUB. It might depend on what is your definition of handicap. How many employees do you have in your business?

Ms. WOERNER. We work in home health care, so we have about 72.

Mr. DAUB. Do you have an independent contract relationship with them, or are they straight salaried employees?

Ms. WOERNER. Salaried. Twenty-seven employees are full time, and 45 are part time.

Mr. DAUB. What is the relationship of male to female?

Ms. WOERNER. We have three men.

Mr. DAUB. I am relieved to hear that you have three.

Mr. MITCHELL. Does the gentleman want to abandon that line of inquiry?

Mr. DAUB. No, as a matter of fact, I think I made my point.

Ms. WOERNER. Let me also say we have nine professionals. Those are aides.

Mr. DAUB. On top of the 27 and the 45?

Ms. WOERNER. The 72 are aides who would be doing direct delivery of services, and our professional people are the ones who would be doing research and policy studies of the type that is done by the Federal Government, so we really have nine professionals who would be competing, doing research.

Mr. DAUB. Do you have a corporation form?

Ms. WOERNER. Yes, sir.

Mr. DAUB. A stock company?

Ms. WOERNER. Yes, I own 100 percent.

Mr. DAUB. Do you own it all? There is no man that owns any stock in your business?

Ms. WOERNER. You could make an offer.

Mr. DAUB. Are you saying your business is for sale?

Ms. WOERNER. Some days it is pretty rough out there.

Mr. MITCHELL. If the gentleman will hold for just a moment. Quite seriously, I want to caution our audience about the participatory parts that come up once in a while. Generally we try to persuade those who are guests here not to vent their emotions either in terms of approval or disapproval.

Mr. DAUB. I certainly appreciate your admonishment of the audience.

I would like to commend your interest in breaking into the Beltway Bandit complex of the Washington, D.C., area by virtue of recognizing what it takes in resources, information, to write a proposal. I have an advisory committee that works with me on 8(a) problems in my own district, and I find that it is particularly difficult for women, and women businesses to get a start, let alone get time from a contracting officer. I think the original seed for most 8(a) businesses comes from that discovery of a potential window work contract, security contract, or janitorial, supply contract. Then someone says, "I wonder if," and then finds out you can't bid on it and you can't possibly compete, because the competitor is the person you buy your supplies from.

You made a good point, and it is good it is in the record. You make a point it is hard to break in, but we shouldn't draw lines and it should be for socially disadvantaged, and women who are just as much a part of that pie as are others. I am not sure if you feel we should make some effort to establish a quota within a quota.

Ms. WOERNER. I wouldn't be very interested in trying to say who is the most disadvantaged. That is very difficult.

Mr. DAUB. How would you propose that that judgment be addressed by the administrator and the field officers who have to deal with this question?

Ms. WOERNER. I would hope that, from a management point of view, they would just enforce the interim rule saying if you can prove a clear and convincing case on a case-by-case method, if you can prove that, that you should be admitted; and as I say, I think that is important that we not worry so much about the number of companies.

I think all of it needs to be on a competitive basis. We shouldn't be too concerned about the companies that don't get business. They are not entitled to business. We are not entitled to be in small business.

You have to get out there and it is rough out there.

Mr. DAUB. That is a good point, and I want to close by asking a little bit in a followup to my colleague, Mr. Hiler. As your business is profitable, do you have a net net after tax, after everything, amounts left in your bank account, that is not just on paper like good will on a balance sheet, but in fact money and you are in the program now certified?

Ms. WOERNER. Yes.

Mr. DAUB. And you do for a period of time in the future plan to obtain some set-aside negotiated business from the Government?

Ms. WOERNER. Right.

Mr. DAUB. What is the criterion in your mind for when you would be graduated? Have you had to sign an agreement, did you not, to indicate your graduation date yet? You didn't have to do that this time, did you?

Ms. WOERNER. No.

Mr. DAUB. You are aware that is proposed in the interim regulation.

Ms. WOERNER. Yes, sir.

Mr. DAUB. Speculate in your own business, where would it fall in your case, by dollars, years, by how? What criterion would be applied?

Ms. WOERNER. I think you might most appropriately look at percentage of your total volume and expect that you would go up through some kind of, GAO mentioned a tiered approach.

I would see it going through as a percent of your business, a percent of your total business for your industry or something like that. Say that you should start out with more 8(a) contracts and then move down and do less 8(a) and more small business set-aside contracts and finally more competitive business. So I would see it as a percentage type of thing, not a dollar type of thing.

In other words, you should move from a totally, if you want to say totally, but from an 8(a) dominated business to small business set-aside dominated.

Mr. DAUB. I am worried about something. What if you don't do your part of the bargain? What if SBA sets a table of 5 years, and goes from $1 million to $800,000 to $400,000 to try to get you to do your own private thing?

Ms. WOERNER. SBA has some obligation to try to help you, because they have agreed with you on what the plan is. If it becomes clear after a number of years, no matter how much help, you can't do it, then it is just over.

Mr. DAUB. Thank you.

Mr. MITCHELL. Thank you very much.

I would like for the record to show, however, that the 8(a) program is not, is not a quota program.

Ms. WOERNER. That is right.

Mr. MITCHELL. There is nothing in the act which establishes quotas, and I think it is important to dispel that notion.

Mr. DAUB. If you will yield for a moment.

Mr. MITCHELL. In just a moment.

I think it is important to dispel that notion, that it is a quota program. In my opinion, there is a very definitive distinction between set-asides and quotas.

I yield.

Mr. DAUB. To clarify, I was trying to get at a method by which percentage might be set for women versus nonwomen, regardless of any other kind of definition of their being socially disadvantaged. I did not mean to imply that the 8(a) program was quotaed, although I would point out for the record, that Executive Order 11625, I believe, does indicate that every agency will set aside a certain amount of their business for 8(a) if that is at all possible. The Corps of Engineers in my district announced that they were 200 percent of goal for 8(a) under the last Executive order in 1979-80. So I am not saying that is a quota, but there is an encouraging word from the last Executive order that such a level of dollar volume be subject to 8(a) potential.

Mr. MITCHELL. This is not the time for us to engage in the semantics of the word, but I would disagree with you that that even suggests quota. I knew where you were going in your line of inquiry.

I wanted to make the record clear, because there are so many mistaken notions about the 8(a) program that in a public hearing like this, even if the word quota is mentioned, it becomes misinterpreted by many participants in the audience.

We have a series of votes that we have on the floor.

I would like to suggest maybe after a 15-minute break, we resume. Let's break until 1 o'clock, and we will try to get the last three witnesses in.

[A recess was taken.]

Mr. MITCHELL. It is now 1 o'clock and our hearing will resume.

Our next witnesses are Mr. Eugene Baker, president of the National Association of Black Manufacturers, and Mr. Les Lepow, attorney and counsel to several members of the National Association of Black Manufacturers.

Gentlemen, welcome to the hearing.

You are not strangers to this subcommittee, nor to the full committee.

TESTIMONY OF EUGENE BAKER, PRESIDENT, NATIONAL ASSOCIATION OF BLACK MANUFACTURERS AND LES LEPOW, COUNSEL

Mr. **Baker**. Thank you, I would like to request I summarize my testimony, and however, at the same time, I would like to ask that the entire prepared statement be submitted for the record.

Mr. **Mitchell**. Without objection, your entire statement will be submitted as an official part of the record.

Mr. **Baker**. Mr. Chairman and members of the committee, we would like to thank you for this kind invitation to appear and testify here before you. I am accompanied today by Les Lepow, an attorney with the law firm of Squire, Sanders & Dempsey and counsel to several NABM members.

We are primarly concerned with actions recently taken by SBA to terminate a number of economically and socially disadvantaged firms from the 8(a) program. This is being done in an abrupt de facto manner with absolutely no due process protection.

As we all know, the 8(a) program directs Federal dollars to socially and economically disadvantaged firms which sorely need that assistance in order to attain competitive viability in this free enterprise system of ours. In terms of total Federal procurement dollars, the 8(a) program is only a drop in the bucket. Let me illustrate it this way: Since the program began nearly 12 years ago, SBA has subcontracted approximately $5 billion in contracts among a portfolio of close to 4,000 firms. Compare this with the fact that in fiscal year 1980, the Defense Department awarded more than that to only 2 major firms alone. In fiscal year 1980, 8(a) procurement made up less than 2 percent of all Federal procurement. How can it be said, then that 8(a) firms are pirating away business from the rest of corporate America?

Although the 8(a) program is relatively small, it has been the object of criticism from many corners. Much of this criticism has been constructive, and both Congress and SBA have responded by effectively tightening up the program—new advance payment and business development expense procedures have been adopted; both Congress and SBA have provided more specific eligibility criteria; and SBA has adopted new sponsorship rules.

Another measure taken by Congress to tighten up the program was the recent enactment of a law requiring SBA to promulgate graduation regulations. SBA has just begun this process. More precise regulation in this area is clearly necessary, but the regulations as proposed are inflexible and nonresponsive to the hard economic realities faced by socially and economically disadvantaged firms. We are also troubled by recent SBA actions to terminate firms from 8(a) contract support based upon unfair size determinations. I will now address myself to these two serious problems—graduation and termination for apparent violation of SBA size standards.

I will first discuss SBA's proposed graduation regulations. Just a few days ago, SBA issued proposed graduation regulations which would establish a 3 to 5 year cap on 8(a) contract support for each firm, depending on the firm's industry—a 3-year maximum for service, and a 5-year maximum for construction and manufacturing, with the possibility of one 1-year extension in any category.

No studies or statistical analyses are cited anywhere in the notice of proposed rulemaking to support the imposition of these arbitrary caps, which are inconsistent with prior SBA studies and congressional determinations:

Item 1, the 3 to 5 year limits are considerably shorter than those considered necessary by SBA's own independent section 8(a) review board in 1978.

Item 2, adoption of the 3 to 5 year caps would be in direct conflict with the plain meaning and spirit of Public Law 96-481. Drafters of that bill specifically rejected a fixed period of years and substituted a requirement that SBA adopt regulations more sensitive to geographic location and other specific factors.

Item 3, the 3 to 5 year proposal does not focus at all on each firm's ability to attract equity capital in the marketplace. Prior SBA studies indicate that the ability to attract equity capital is a benchmark for determining viability, and that developing that ability requires well more than 5 years, which is the Casey study already alluded to by previous witnesses.

Administrator Cardenas has cited, and I quote, "common business sense" as the basis for the 3 to 5 year caps. Yet, I am happy to see that SBA has put these regulations out for comment because, quite frankly, common business sense does not support a uniform and arbitrarily determined tenure in the 8(a) program for all participants.

Now, we are not looking for perpetual Federal assistance, but even SBA's own studies demonstrate that a more flexible rule on graduation is needed. It will be a waste of Federal funds if firms are forced out of the program after the maximum 4 or 6 years—assuming they can get an extension—because many will surely fail when only 1 or 2 more years in the program might have allowed them to become competitively viable.

The second problem I would like to discuss concerns the termination of 8(a) firms from program participation because they ostensibly violate SBA size standards.

For a firm to be eligible for admission to the 8(a) program, the firm must be small as defined by SBA's own size standards. However, the manner in which SBA may be attempting to apply these regulations is quite disturbing.

First, SBA must decide which size standards it will apply. In 1980, SBA initiated a rulemaking proceeding to revise exactly the same size standards it is now applying to 8(a) firms in order to terminate them. We would like to know what prompted that rulemaking proceeding. SBA itself determined that the existing size standards were outdated and did not reflect inflationary trends. We are surprised and dismayed that SBA has ignored its own findings and is attempting to apply the very size standards it found faulty in order to terminate as many 8(a) firms as possible, as quickly as possible. Why?

The second question that arises is how to determine whether an 8(a) firm is large for SBA purposes under any set of standards. There are strong indications that SBA is determining a firm's size based on awarded contract dollars rather than on actual receipts. Yet, many firms are awarded contracts with inflated dollar values that far exceed the receipts actually obtained.

Clearly, the awarded contract value cannot be used as a size indicator, and the practice of using it as such should be stopped.

A related issue involves the type of business that should be counted to determine a firm's size. No matter what size standards SBA applies, the amount of 8(a) business, as opposed to commercial or non-8(a) business, that is done by a firm should be completely or partially discounted in determining a firm's size for purposes of continued eligibility in the program.

If SBA assesses the size of each 8(a) firm currently in the program by tallying together both 8(a) and non-8(a) business, many firms will be considered too large for continued participation in the program when, in reality, they are not. For if such firms are terminated from participation and lose all of their 8(a) business, the result may very well be a small business. That is, the amount of non-8(a) business remaining may be such that the firm would actually be eligible for 8(a) assistance under SBA size standards.

And the scenario will not be a pretty one: Firms abruptly cut off from 8(a) contracts on that basis may be forced to lay off employees and sell plants, equipment, and other capital investments; many firms will fail.

We submit that only a firm's commercial business accurately measures its size for SBA purposes. If SBA relies on the amount of artificially injected 8(a) support a firm receives in determining its size, many firms will be terminated on the basis of completely unreasonable and unrealistic size determinations.

Critics of such a method of size calculation may argue that it will provide a disincentive for a firm to take on non-8(a), commercial support. This potential problem is effectively precluded by the proposed graduation regulations. Moreover, failure of an 8(a) firm to grow commercially is a separate ground for termination under SBA's regulations.

Several other problems are manifest in SBA's new get tough policy on size. Historically, SBA has made it a practice to approve 8(a) support levels arguably in excess of size standards subsequent to program entry. Indeed, in January 1981, SBA codified this practice when it issued a final rule stipulating that a size determination under SBA regulations is advisory for program participation purposes.

Relying upon this historic practice on the part of SBA, many 8(a) firms hire extra employees, borrow money, expand facilities. But Administrator Cardenas has suddenly changed horses in midstream by taking the position that size is not advisory but that it dictates termination. If Mr. Cardenas truly intends to implement such an abrupt change in policy, SBA should initiate a separate rulemaking proceeding and allow affected firms an opportunity for comment.

Still another problem is the practical effect the size standard cases and termination proceedings have on 8(a) firms in the process of negotiating contracts. The regulations and cases are clear that an 8(a) firm has a right to be considered eligible for support until a final decision in accordance with the Administrative Procedure Act has been made in a program completion or termination proceeding.

But, as papers already filed in a Federal district court indicate, SBA is balking on processing 8(a) contracts to firms which have not yet even been notified that they will be terminated because of their alleged size. This practice must stop immediately.

Finally, Administrator Cardenas has tainted the entire program completion process by publicly stating that commonsense dictates a 3 to 5 year maximum tenure in the 8(a) program. It is highly likely that the Associate Administrator for Minority Small Business/Capital Ownership Development will render decisions concerning completion that are unduly influenced by the fact that the Associate Administrator is now ultimately answerable to the Administrator; and this Administrator has used his own brand of "common business sense" to predetermine that 3 to 5 years is a sufficient amount of time for program participation.

Administrator Cardenas' personal prejudgment on the appropriate time period for 8(a) program participation destroys any possible appearance of fairness in the program completion hearings. He must be instructed to sever himself from any interference with the Associate Administrator's adjudicative function in completion hearings.

These comments are offered in a spirit of deep concern for not only the continued viability of minority-owned firms, but also for the continued viability of the 8(a) program itself. We can only hope that the Members of Congress, and especially this committee, will carefully monitor the actions of Administrator Cardenas in this regard and the rulemaking proceeding currently underway.

I thank you for your concern and will answer any questions you might have at this time.

[Mr. Baker's prepared statement follows:]

PREPARED STATEMENT OF EUGENE BAKER, PRESIDENT, NATIONAL ASSOCIATION OF BLACK MANUFACTURERS

Mr. Chairman, thank you for your kind invitation to appear and testify before this Committee. I am accompanied today by Les Lepow, an attorney with the law firm of Squire, Sanders & Dempsey.

Our primary concern today is the fact that recent actions by the U.S. Small Business Administration evidence what we believe to be an attempt to terminate many economically and socially disadvantaged firms from the SBA's Section 8(a) Program in an abrupt, de facto fashion without due process protection.

As we all know, the 8(A) Program is the primary vehicle by which federal government dollars are used to assist economically and socially disadvantaged firms to attain competitive viability. The 8(a) Program is not a large one, in terms of total federal procurement dollars. Since its inception, approximately 12 years ago, SBA has awarded approximately $5 billion in contracts among a portfolio of approximately 4,000 firms. To put this into perspective, in fiscal Year 1980 alone, the Defense Department awarded more than that to 2 firms alone. In that same fiscal year, 8(a) dollars represented less than 2 percent of all federal procurement. It can hardly be said that 8(a) represents a significant "pirating away" of corporate America.

Although the 8(a) Program is not a large one, it has certainly inspired a large chorus of critics. Charges of advance payment abuse, eligibility abuse, "fronts", and wasted business development expenses have appeared in the press for several years. Responding to these charges, both the SBA and Congress have tightened the rules and procedures of the Program: new advance payment and BDE procedures were adopted several years ago; Congress provided more specific eligibility criteria to SBA in Public Law 95-507; and SBA adopted new "sponsorship" rules.

Similarly, in an effort to address the problem of "graduating" firms from the 8(a) Program, Congress required SBA to issue new program graduation regulations. SBA has now begun that process. We believe that regulations are needed but we are very concerned that SBA's proposed regulations are inflexible and not responsive to the economic realities disadvantaged firms face. Equally troublesome are recent SBA actions by which firms are being terminated from contract support based upon the unfair determination that the firms are "large businesses" and, therefore, ineligible for 8(a) contract support. We would like to address these two problems of graduation and termination for apparent violation of SBA size standards.

1. SBA'S PROPOSED GRADUATION REGULATIONS

On June 1, 1981, SBA published its proposed graduation regulations in the Federal Register. These regulations adopt relatively hard and fast rules by which firms would receive between 3 and 5 years of contract support depending on their industry (3 years for service, 5 for manufacturing). Apparently this proposal is based on no studies and, indeed, is inconsistent with prior SBA studies and Congressional determinations. For example:

(a) The 3-5 year limits are considerably shorter than those considered necessary by SBA's own independent Section 8(a) Review Board in 1978. see Joint Hearings on Minority Contracting Before the Senate Select Comm. on Small Business and the Subcommittee on Minority Enterprise & General Oversight of the House Comm. on Small Business, 95th Cong., 2nd Sess. 51 (Feb. 6, 1978).

(b) Adoption of a uniform rule would be in open conflict with the reasoned language and spirit of Public Law 96-481 which specifically rejected a fixed period of years and substituted a requirement that regulations more sensitive to geographic location and other specific factors be adopted. See H.R. Rep. 96-1434 at 16; S. Rep. 96-974 at 22.

(c) The 3-5 year proposal does not really focus on a firm's ability to attract equity capital in the marketplace, which prior SBA studies have indicated to be a benchmark for determining viability and to require well more than 5 years. See Report of the SBA Task Force on Venture and Equity Capital for Small Business 4-7 (1977); National Association of Securities Dealers, Joint Industry/Government Committee on Small Business Financing: The Current Environment and Suggestions for Improvement 8-10 (1979).

When Administrator Cardenas was asked by the Chairman of this Subcommittee two weeks ago which studies SBA would rely on in proposing a 3-5 year tenure for 8(a) participation, Administrator Cardenas responded "common business sense" and the benefits of a "sheltered program." We are happy to see that SBA has issued these regulations for comment because we do not believe that common business sense justifies a uniform rule on graduation for all 8(a) participants of only 3-5 years. We do not seek cradle-to-grave help, but if studies show that the "learning curve" for firms to attain viability is greater than 3-5 years—and studies, including SBA's own, do so indicate—SBA must adopt a somewhat more flexible rule.

2. TERMINATION FOR "VIOLATION" OF SBA SIZE STANDARDS

This is a somewhat complicated problem. SBA's eligibility criteria, as codified, require that, to be admitted to the 8(a) Program, a firm must be small as defined by SBA's own size standards. We readily concede this point. However, before it applies current size standards to 8(a) firms in a torrent of proceedings with the goal of terminating firms on the ground that they are large, and therefore, ineligible, SBA must answer several important policy questions.

a. Which size standard to apply?

In 1980, SBA commenced a rulemaking proceeding to revise the very size standards it is using to terminate 8(a) firms. Why did it do so? Because SBA itself determined that the existing size standards were outdated and did not reflect inflationary trends. 45 Fed. Reg. 15443 (March 10, 1980). Now SBA is applying those same faulty size standards against 8(a) firms. We find this policy to be ludicrous.

b. How to determine whether a firm is "large"

Determination of the size of an 8(a) firm has also been a problem for many NABM members. Many firms are awarded contracts with inflated dollar values that far exceed the receipts actually recovered. Nevertheless, there are indications that SBA is basing a firm's size on awarded contract dollars rather than on actual receipts. Such a practice is inconsistent with SBA's own regulations and must be stopped.

A related issue is whether the amount of both 8(a) and non-8(a) business should be tallied together in determining an 8(a) firm's size. Regardless of whether SBA attempts to apply the outdated size standards currently on the books, the amount of 8(a) business a firm does should be totally or partially discounted in determining the firm's size for purposes of continued eligibility in the program.

Clearly, if SBA assesses the size of each 8(a) firm currently in the Program by arbitrarily melding together 8(a) and non-8(a) business, many firms will be considered terminable when, in reality, they are not. For once many of these concerns have in fact been terminated from participation in the Program, the result may very well be a small business; that is, the amount of non-8(a) business remaining may be such that the firm would actually be eligible for 8(a) assistance under SBA size standards.

The ramifications of counting 8(a) and non-8(a) business in determining size are profound: firms abruptly cut off from 8(a) contracts on that basis may be forced to lay off employees and to leave plants, equipment and other capital investments lying fallow. And the goal of competitive viability may be irrevocably thrust beyond the terminated firm's grasp.

We would recommend that the 8(a) portion of a firm's business be eliminated from consideration in any size determination. At the very least, that business should be deflated in value (by at least 60 percent) in making such determinations. Only a firm's commercial business accurately measures the firm's size in terms of its continued need for SBA contract support. Relying on an improper amalgamation of commercial business and artificially injected 8(a) support will result in completely unrealistic and unreasonable size determinations.

Critics of such a method of size calculation may contend that it will provide a disincentive for a firm to take on non-8(a), commercial support. This potential problem is effectively precluded by proposed graduation regulations. See proposed § 124.1-1(f)(5)(ii), (iii), (vi). Moreover, failure of an 8(a) firm to grow commercially is a separate ground for termination. See 13 C.F.R. § 124.1-1(e)(1) (xiv).

c. Is termination for size a new SBA policy which by itself requires rulemaking?

In January of 1981 SBA issued a final rule, after notice and comment in conformance with the Administrative Procedure Act, that provided in pertinent part that a size determination under SBA regulations is advisory for program graduation purposes to the SBA Associate Administrator for MSB/COD Programs. This regulation was and is consistent with an historic SBA practice of approving 8(a) firms' business plans and annual projected requirements although they would exceed size standards subsequent to program entry. Based upon this historic practice of approving support levels arguably in excess of size standards, many 8(a) firms hire extra employees, borrow money, expand facilities, etc. Now, as of May 1, 1981, the Administrator of SBA has taken the position that size is not advisory but that it dictates termination. We believe that this change of policy, given the disastrous results that it will cause 8(a) firms, requires a separate rulemaking proceeding and an opportunity for comment by affected firms.

3. DE FACTO TERMINATIONS

Another problem which concerns us is the practical effect the size standard cases and termination proceedings have on 8(a) firms in the process of negotiating contracts. Will agencies which have negotiated contracts with 8(a) firms in anticipation of the firm's continued 8(a) participation stop doing so because the firm's name appears on an SBA press release purporting to name the firms which have received the most 8(a) support (which implies that the firm is large)? The regulations are clear and the case law well settled that an 8(a) firm has a right to be considered eligible for support until a *final* decision in accordance with the Administrative Procedure Act has been made in a program completion or termination process. But, as papers already filed in a federal district court indicate, SBA is balking on processing 8(a) contracts to firms which have not yet even been notified that they will be terminated. *Amex Systems, Inc., et al.* v. *Cardenas* (D.D.C. Civ. No. 81-1223, filed May 27, 1981).

4. PREJUDGMENT PROBLEMS

In a statement before this Subcommittee two weeks ago and in a press conference on May 1, 1981, Administrator Cardenas expressed his belief that "common business sense" mandates a 3-5 year cap on any firm's participation in the 8(a) Program. These statements raise serious questions of prejudgment. Under SBA's program completion regulations, 13 C.F.R. § 124.1-1(d)(3), firms determined by SBA to have substantially achieved the objectives of the 8(a) Program are to be afforded a hearing on the record in accordance with the Administrative Procedure Act and SBA's Rules of Practice for Adjudicative Hearings. Section 124.1-1(d)(4) of SBA's rules provides that the Associate Administrator for Minority Small Business/Capital Ownership Development shall, based on the record established at such hearing, "render a final decision regarding the completion of the Section 8(a) business concern's participation in the program". (The current regulations similarly provide that the AAMSB/COD renders final decisions in termination cases, after a full hearing.) However, Public Law 96-491 places the AAMSB/COD "under the supervision of, and responsible to, the Administrator" on all matters relating to the 8(a) Program. 15 U.S.C. § 636(j)(10). Clearly, therefore, the final decision of the AAMSB/COD as to whether a firm has substantially achieved the objectives of the 8(a) Program may be unduly influenced by the fact that the Associate Administrator is ultimately answerable to an Administrator who has used his own "common business sense" to determine that 3-5 years is sufficient for Program participation. To the extent that the Associate Administrator's adjudicative impartiality is tainted by his superior's prejudgment, firms faced with program completion hearings may have their due process and APA rights violated. Administrative hearings "must be attended, not only with every element of fairness, but with the very appearance of complete fairness". *Cinderella Career and Finishing Schools, Inc.* v. *FTC*, 425 F.2d 583, 591 (D.C. Cir. 1970); *Texaco, Inc.* v. *FTC*, 336 F.2d 754, 760 (D.C. Cir. 1964); *Amos Treat & Co.* v. *SEC*, 306 F.2d 260, 267 (D.C. Cir. 1962). Administrator Cardenas' personal prejudgment on the appropriate time period for 8(a) Program participation destroys any possible appearance of fairness in the program completion hearings. He must be instructed to divorce himself from any interference with the AAMSB/COD's adjudicative function in completion hearings.

Mr. **Mitchell**. We thank you very much for your testimony. I want to ask for the number of firms that are in your association. Give me an idea, if some others came down saying that all of the manufacturers who are part of your association who were certified as 8(a) would be graduated from the program, as of September of this year, from your best knowledge, how many of them would be able to survive in the free enterprise system without any support?

Mr. **Baker**. None.

Mr. **Mitchell**. Why is that?

Mr. **Baker**. Take even the companies in the manufacturing area. As you know, the association is made up of various facets of minority business, but let's deal with the manufacturers.

We have not established a track record to deal with the learning curve, the ability to acquire capital, even to acquire equipment to compete with the big guys. In automated situations, it would take anywhere from 5 to 6 years. Until the pilot program, we were not involved in high technology efforts, only dead-end items. This would be a valid reason that most of them would go under.

Mr. **Mitchell**. All right, of the number of manufacturing associations, companies in your association, if a mandate came down from SBA saying that all such firms who presently have 8(a) contracts would not receive any more 8(a) contracts for a nondefined period of time or forever, how many of your companies would survive?

Mr. **Baker**. Am I correct, are you saying that if a mandate came down?

Mr. **Mitchell**. Not to graduate them, but simply saying you will stay in the program but as of now it is another form of graduation really, as of now, you will get no more 8(a) contracts.

Mr. **Baker**. The answer would almost be the same as the first. This is what is frightening us now. Through the de facto process the Administrator has taken the liberty not only to send the hit list to the various regions through the country, but he also issued that same list to the various procuring agencies, and where contracts have been in the works and already designated to various companies, now these contracts are being held up.

Mr. MITCHELL. In testimony before this subcommittee last week, Mr. Cardenas announced, we made him aware of the impact of his public statements and the internal administrative changes he was recommending. We pointed out to him that that impact was very negative insofar as the other agencies of Government were concerned, the other procurement agencies.

In response, he said words to this effect, that on that very day he would send out correspondence to the various Federal agencies pointing out that in no way should pending contracts be negatively impacted because of his public statements, or because of the proposed rules.

Are you aware of that?

Mr. BAKER. Mr. Chairman I can go on record, as of this date, the same practice is being undertaken. Contracts are being held up. Advance payments are being held up. BDE's are not being issued.

If you would like for me to, I will submit names and companies for the record.

[See affidavits marked "Testimony References" page 138.]

Mr. MITCHELL. That would be very helpful, because it places us in a very difficult position if a public servant comes before a committee of Congress and says that he or she will take the action necessary to remedy a situation, and either, one does not do it, or the other agencies of Government ignore that effort, it places us in almost an untenable position, so I would like to know the names of the companies that had contracts pending with various agencies of Government and what their status is.

Mr. LEPOW. If I might say, we are very troubled by what we perceive as a pattern of de facto terminations of firms currently participating in the section 8(a) program by Administrator Cardenas' actions.

On May 1 he published a memorandum directing his field offices to initiate size standard cases on a list of firms.

He also directed them that if they find any firm to be large under the admittedly faulty size standards which we have referenced, they immediately inform the central office of this fact. If, notwithstanding the fact that the firm is large, they want to go forward with an award to that firm, they are required to list other 8(a) firms capable of doing the job who are not large.

We have a copy of that memorandum and will supply it for the record.

[Memorandum submitted by Mr. Lepow follows:]

SMALL BUSINESS ADMINISTRATION,
Washington, D.C., May 1, 1981.

To: All Regional Administrators.
From: Michael Cardenas, Administrator.
Subject: New applications for section 8(a) program; temporary moratorium.

Effective immediately new Section 8(a) applications will not be accepted until further notice. Those 8(a) applications received prior to the date of this instruction will be processed in accordance with SOP 80-05.

This moratorium is designed in order to allow us time to implement necessary changes in the 8(a) Program in accordance with Public Law 96-481.

MICHAEL CARDENAS, *Administrator.*

SMALL BUSINESS ADMINISTRATION,
Washington, D.C., May 1, 1981.

To: All Regional Administrators.
From: Michael Cardenas, Administrator.
Subject: 8(a) Program—Field direction.

You are hereby directed to immediately initiate the following procedural changes in the 8(a) Procurement Program.

USE OF BUSINESS DEVELOPMENT EXPENSE (BDE)

Any intended use of BDE in excess of 15 percent or $50,000 on a single 8(a) subcontract must be approved by the Administrator's Office. In addition to use of BDE more than once to an individual contractor must also be concurred in by the Administrator's Office. These referrals must be accompanied by a written detailed justification and recommendation from the Regional Administrator.

ADVANCE PAYMENT

Any intended use of advance payments in excess of 40 percent or $100,000 on a single contract must be approved by the Administrator's Office. In addition the use of an advance payment on more than one 8(a) subcontract at a time must also be approved by the Administrator's Office. All advance payment referrals must be accompanied by a written detailed justification and recommendation from the Regional Administrator.

CONTRACTS

All contemplated 8(a) subcontracts in excess of $2,000,000 must be reviewed by the Office of the Administrator prior to contract selection. These intended subcontracts must be accompanied by a written analysis and justification from the District Director and the Regional Administrator. This analysis should include but is not limited to a review of the business plan in connection with the particular contract. In addition the analysis should include a detailed statement of the 8(a) concerns responsibility to perform on the contract.

WAIVERS

Any and all waivers of the 8(a) Standard Operating Procedure (SOP) 80-05 will be made by the Administrator only. All intended waivers must be accompanied by a written analysis and justification from the District Director and Regional Administrator.

This directive is effective immediately.

MICHAEL CARDENAS, *Administrator.*

SMALL BUSINESS ADMINISTRATION,
Washington, D.C., May 1, 1981.

To: All Regional Administrators.
From: Michael Cardenas, Administrator.
Subject: Size review of 8(a) firms.

You are directed to immediately initiate a size review of the attached list of 8(a) firms. This investigation will be conducted in accordance with the SBA Size Regulations and will be performed by those personnel who routinely handle size reviews. These reviews will culminate in a formal Regional Office size decision. The Central office will be provided a copy of this decision at the same time the 8(a) firm is notified. Those 8(a) firms found to be other an a small business will be informed of their appeal rights under SBA's size regulations. (Sec. 13 CFR 121.3-6) 8(a) firms will not be permitted to change their business designation in order to change their size status. If you are aware of any 8(a) firms not shown as the attached referenced list that you feel may exceed the applicable size regulations, you are also directed to perform a size decision on those firms. Termination or completion proceedings of those forms found large will be initiated immediately.

Any prospective procurement awards to those firms found large must be referred, with a written recommendation from the Regional Administration, Assistant Regional Administrator/Minority Small Business Capital Ownership Development, and the District Director, to the Central Office. These recommendations should address the elements of responsibility and responsiveness of the particular 8(a) concern for the contract in question. In addition the recommendations should include your selection analysis and the names of the other eligible 8(a) firms determined capable of also preforming this requirement. The recommendations will be referred to the Associate Administrator Minority Small Business/Capital Ownership Development.

Your immediate attention to this direction is requested.

Michael Cardenas, *Administrator.*

Region I

Input Output Computer Services.

Region II

Glopak Corp.; Urban Data Systems, Inc.; Unified Services; and Thom Tex Paper Converting.

Region III

Unified Industries; OAO Corporation; Fletcher & Sons, Inc.; Systems and Applied Sciences; Atlantic Personnel; Rehab Group, Inc.; International Business Services; Systems Research, Inc.; JWK International; Automated Datatron, Inc.; Systems Management Assoc.; A. L. Nellum & Assoc.; Interamerica Research Assoc.; Technassociates, Inc.; Chesapeake Interprises; Meldick Services, Inc.; National Institute for Advance Studies; Chen Printing; Webbs Full Service, Comp.; and Raven Data Processing, Inc.

Region IV

Pryor Interprises; Chucko, Inc.; and Garrett, Sullivan, Comp.

Region V

Thacker Construction and Sherman Smoot Comp.

Region VI

Harris System Pest Control; Bluford Service, Co.; and H. & H. Meat Co.

Region VII

Lewis Management & Services, Co. and Groves Contract Services, Inc.

Region VIII

Joseph M. Osoro Consultant Association.

Region IX

Annex Systems; Technology Development Corp.; Superior Engineering and Electric Comp.; Smith Engineering and Contract Service; Western Addition Metropolitan Services; Willa Brokenbaugh Enterprises, Inc.; Harris Management Co.; Cabrillo Food Management; and Inter-Con Security Services.

Region X

P. & B. Services, Inc.

Mr. Lepow. The practical effect of this memorandum is as follows: The field offices are understaffed, and they are getting directions stating "If you want to go forward with any of the firms on this list, you will have to justify it and go through many more intra-agency procedures than you ever had to before."

They are not processing contracts for those firms or indeed for firms who are not on the list, and I know of an example of that and will provide it for the record also.

[See affidavits marked "Testimony References" page 138.]

When SBA begins these size standard cases, they begin by sending a form letter to the firm saying, "You have to provide this material to the administration within 3 working days, and if you do not provide it timely, we will presume that you are large." I have a copy of one of those letters.

[Attached letter follows:]

U.S. SMALL BUSINESS ADMINISTRATION,
PHILADELPHIA REGIONAL OFFICE,
Bala Cynwyd, Pa., May 15, 1981.

Mr. A. L. NELLUM,
A. L. Nellum and Associates, Inc.,
Washington, D.C.

DEAR MR. NELLUM: The size status of your firm in connection with your participation in the 8(a) program under Public Law 95-507 has been questioned by the Regional Administrator, Region III, of the Small Business Administration.

The Regional Programs Division will perform the review of your size status in accordance with Part 121, SBA Rules and Regulations. a copy of which is attached; procurement size standards specified in Part 121.3-8 will be used.

In accordance with the provisions of the above mentioned regulations, you are requested to complete and return two (2) copies of the attached SBA Form 355 which must be signed by an officer of the firm and returned to this office within three (3) working days after receipt of this letter. Please note that Form 355 requires that a copy of the latest annual report and a copy of the bylaws for each corporation be returned with the completed form.

The size review will be based on your primary industry business activities and average annual receipts for the preceding three (3) fiscal years.

"Annual receipts" means the gross income (less returns and allowances, sales of fixed assets, and interaffiliate transactions) of a concern (and its affiliates) from sales of products and services, interest, rents, fees, commissions, and/or from whatever other source derived, as entered on its regular books of account for its most recently completed fiscal year (whether on a cash, accrual, completed contracts, percentage of completion, or to other acceptable accounting basis) and reported or to be reported to the U.S. Treasury Department, Internal Revenue Service for Federal income tax purposes.

Copies of tax returns or financial statements for parent corporation and all affiliated companies for the last three fiscal years must be submitted with your application.

In addition to all other required information, provide separately, total 8(a) receipts and total non 8(a) receipts for fiscal years 1978, 1979, 1980, 1981 (thru March).

It is necessary that a completed list of all officers and directors be supplied indicating their individual percent of stock ownership. A list of all stockholders owning more than ten percent must be supplied. All outstanding stock must be accounted for. List full names (initials only are not sufficient) and addresses of owners, partners, officers, directors, and principal stockholders in accordance with instruction 9 of SBA Form 355.

If any of the persons so named is the owner or a partner in, or is an officer, chairman of the board of directors, or principal stockholder of any other business concern (including foreign concerns) or if such concern owns any voting stock in any other concern, the information required under the above must be provided for such other concern(s).

Please indicate by name and address all business firms with which your concern or any subsidiary has any contractual relationship involving ownership (voting trust agreements for stock, stock options, joint ventures, merger agreements), advisory service (consulting agreement, technical or financial), use of common facilities, trade agreements, financial assistance for bonds, loans, etc. Please supply a copy of each such agreement. A negative relpy is required if no agreement exists.

Please be advised that the same provisions applicable to the completion of SBA form 355 also apply to the information provided in response to this letter; namely, it is a violation of Section 16(A) of the Small Business Act to make a wilfully false statement or misrepresentation to the Agency for the purpose of influencing in any way the action of the Small Business Administration.

We urge you to exercise due diligence in submitting necessary evidence and arguments to this office for the initial size determination. The Size Appeals Board generally will not review issues or evidence not previously presented to the office making the initial size determination.

If completed SBA Form 355 is not received within the time frame specified above, SBA will rule your firm to be other than small business. If you have any other questions, please contact the writer at 215-596-5979.

Sincerely,

JOSEPH A. MONTELEONE,
Acting Assistant Regional Administrator
for Regional Programs.

SMALL BUSINESS ADMINISTRATION
APPLICATION FOR SMALL BUSINESS SIZE DETERMINATION

Read carefully the instructions on page 4 and the Small Business Size Standards Regulation before completing this form
(Applications not fully completed will not be accepted)

I. Information relating to Applicant only:

1a. Name and address of applicant: (Street, City, State and ZIP Code)

b. Located in ______________________ county.

c. Name and title of person authorized to supply further informati

Telephone No: ______________

d. Total sales or receipts of applicant for each of its most recently completed three fiscal years:
19____ $ ______________
19____ $ ______________
19____ $ ______________
Total $ ______________

e. Total assets of applicant:
$ ______________

f. Net worth of applicant:
$ ______________

g. Applicant's primary business activity:

h. Average net income of applicant after Federal income taxes, for preceding two fiscal years: (Average net income to be compute without benefit of any carry-over loss)
$ ______________

i. Applicant's number of employees (exclude affiliates). See "Instructions" for definition of term "number of employees."
____

j. Determination requested for purpose of receiving:
SBA Business Loan ☐
Assistance from an SBIC ☐
Government Prime Contract ☐
Government Subcontract ☐
Other (Specify) ______________

2. Applicant's major products or services	Total sales or receipts for its most recently completed fiscal year: Quantity	Value	SIC Industry Cod
		$	

3. Does applicant issue or operate under franchise, license or other contractual agreements with another concern? ☐ Yes ☐
If answer is yes, a copy of the contract must be attached to this application.

4. Names & addresses of owner, partners, officers, directors, & principal stockholders of applicant: (Street, City, County, State and ZIP Code)	Offices held in applicant	Percent of [illegible] of business [illegible]

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5a. Are any stock options outstanding? ☐Yes ☐No. If yes, identify person or concern holding option and furnish copy of agreeme

b. Has applicant agreed to merge with another concern in the future? ☐Yes ☐No. If yes, furnish details and copy of applicable documents.

c. Is any stock voted under a proxy agreement or voting trust? ☐Yes ☐No. If yes, a copy of the agreement or trust, together with any explanatory material must be attached to this application.

6a. Are any of the persons listed in question 4 above owners, partners, directors, officers, employees or principal stockholders of any other company? ☐Yes ☐No. If answer is yes complete section 6b below.

b. Name	Company and address (Street, City, County, State and ZIP Code)	Office held	Percent of voting stock of business owned

II. Information relating to Affiliates of Applicant:

7. Affiliates of applicant: (domestic and foreign) Names, addresses (Street, City, County, State and ZIP Code)	Percent of voting stock of affiliate held by applicant	Percent of voting stock of applicant held by affiliate	Affiliate's number of employees (exclude applicant). See "Instructions" for definition of term "number of employees."
a.			________
b.			________
c.			________

8. Names and addresses of owner, partners, officers, directors, and principal stockholders of each affiliate (Street, City, County, State and ZIP Code)	Office held	Percent of voting stock of business owned
a.		
b.		
c.		

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9a. Are any of the persons listed in question 8 above owners, partners, directors, officers or principal stockholders in any other co pany? ☐Yes ☐No. If answer is yes complete section 9b. below.

b. Name	Company and address (Street, City, County, State and ZIP Code)	Office held	Percent of voting stoc or of business owned

10. Affiliate's major products or services	Total sales or receipts for most recently completed fiscal year:		SIC Industry Code
	Quantity	Value	
		$	

11. Do any actual or tacit agreements relating to the operation of the applicant and the affiliates exist? ☐Yes ☐No. If yes, a copy of the agreement and details explaining the nature of these agreements must be attached to this application.

III. Information relating to Applicant and its Affiliates

12. Total sales or receipts of applicant and its affiliates for each of its most recently completed three fiscal years:

19____ $__________ 19____ $__________

19____ $__________ Total $__________

13. Total number of employees of applicant and affiliates. See "Instructions" for definition of term "number of employees" __________

14. Total assets of applicant and its affiliates: $__________

15. Total net worth of applicant and its affiliates: $__________

16. Average net income of applicant and its affiliates, after Federal income taxes, for the preceding two fiscal years (average net income to be computed without benefit of any carry-over loss) $__________

NOTE: If the applicant or its affiliates is a corporation a copy of the latest annual report to its stockholders and a copy of its bylaws for each corporation must be attached to this application.

Section 16(a) of the Small Business Act, as amended, makes it a criminal offense punishable by fine of not more than $5,000 and imprisonment for not more than two (2) years, or both, to make a willfully false statement or misrepresentation to the Small Business Administration for the purpose of influencing in any way the action of the Administration.

CERTIFICATION:

I hereby certify that all information contained above and in exhibits and attachments hereto are true and complete to the best knowledge and belief of the applicant and are submitted for the purpose of inducing Small Business Administration to make a determination as to the size of the applicant, in order that the applicant may receive assistance as a small business under any of the laws administered by this agency.

____
(individual, general partner, trade name or corporation)

By____________________

Title____________________

Date____________________

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INSTRUCTIONS FOR SBA FORM 355

General Instructions

1. Please return the original and one copy of SBA Form 355 to the SBA field office closest to the applicant's principal place of business. Supply all information requested; otherwise it will cause a delay in reaching a determination as to your company's size status. Use additional sheets if more space is needed.
2. This application may be used by anyone seeking a size determination for the purpose of receiving assistance under any act administered by this Agency.
3. Any concern which meets the requirements as a small business as set forth in the Regulation need not submit an application, but may represent on bidding forms or otherwise that it is a small business concern. However, if a protest is received that a concern is not a small business, such concern will be required to complete and submit SBA Form 355.
4. Dominance - See Sec. 121.3-2 of the Regulation. A concern does not automatically qualify as a small business concern merely because it is not dominant in its field of operation.
5. Number of Employees - Means the average employment of concern including the employees of its domestic and foriegn affiliates, based on number of persons employed in a full-time, part-time, temporary, or other basis during each of the pay periods of the preceding 12 months. See Section 121.3-2(a) of the Regulation.
6. Affiliates - See Sec. 121.3-2(a) of the Regulation. All affiliates including foreign and domestic affiliates must be included.
7. Primary Business Activity - In determining the industry in which a concern is primarily engaged, consideration is given to these criteria, among others: Distribution among such industries of receipts, employment, and costs of doing business.
8. All sales or receipts shall be included whether or not part of the receipts have been paid to subcontractors or others.
9. Principal Stockholder means those persons or concerns which own ten or more per cent of the voting stock. In those cases where no individual or concern owns ten or more per cent of the voting stock, please list the five largest stockholders and percentage of stock owned by each. When listing stockholders include banks, insurance companies, stock brokers or stock voted under a voting trust or proxy agreement.
10. If size determination is for a specific procurement or sale, state the IFB or other identifying number and give a detailed description of the product or service involved.
11. Substantial Unemployment and Redevelopment Areas - In addition to listing the county of applicant, state whether the funds to be received by applicant under any of the financial assistance programs will be utilized in a Substantial Unemployment or Redevelopment Area
12. SBA Pools - If applicant is an SBA pool, each participant must submit a separate SBA Form 355.
13. Certification of Application - The person signing the SBA Form 355 must be authorized by the applicant to take such action. If an attorney, accountant or other non-employee of the applicant is to represent the applicant before this Agency then a letter of authorization for such person must be submitted with SBA Form 355.

Instructions for Specific Industries.

14. Grain Elevators - List bushel capacity of all grain elevators.
15. Hospitals, convalescent and nursing homes, medical and dental laboratories and similar privately owned health facilities. Please list number of beds (excluding cribs and bassinets) and total volume of receipts. If applicant is a laboratory, state whether or not it is operated in connection with an eligible hospital.
16. Shopping Centers - Please state gross leasable area. Identify all tenants and list size of area leased to each.
17. Department Stores - List store's gross sales and gross sales in each of the following merchandise lines: (1) furniture, home furnishings, appliances, radio and television sets; (2) a general line of apparel for the family; and (3) household linens and dry goods.

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Mr. MITCHELL. May I interrupt you for just a moment?

This letter would go to a firm.

Mr. LEPOW. From an SBA regional administrator.

Mr. MITCHELL. Let's say that firm is located, I don't believe Seattle is a regional center.

Mr. LEPOW. No.

Mr. BAKER. Use Kansas City.

Mr. MITCHELL. If I may use, take any city where it is not a region, the letter goes out and in 3 days there has to be a reply back to the regional office.

Mr. LEPOW. Right. The letter is sent by certified mail. So it would only be effective upon receipt.

Mr. MITCHELL. Presume that the company replies. We have a situation here in Congress where we received a notice from the postmaster for the Congress, that because of the heavy volume of mail there is as much as a 3- to 5-day delay in receiving it, and getting it out to the offices and in sending the mail out, so if that is true for this very efficient Congress with its postal system, it is not impossible, of course, that a firm would answer promptly and still not reply within the 3-day time limit.

Mr. LEPOW. It would be possible. I am very troubled by it quite frankly and in the interim the contract support is frozen. But the case law, the regulations and the Small Business Act itself are quite explicit on one point. A firm cannot be denied effective participation in the program without getting a hearing in accordance with the Administrative Procedure Act. The firm is getting no notice that it is being terminated, and not being told that it has a right to a hearing or why it is being terminated.

All the contracts are just being frozen. SBA is not saying, "We are terminating them". They are saying, "We are merely conducting a size investigation", and that is a mere guise to get around the due process procedures.

Mr. MITCHELL. I am equally as troubled. You will give us a copy of that?

Mr. LEPOW. There is another problem raised on due process, not so much in the termination arena but in the graduation arena.

As you know, Mr. Cardenas had a problem with the June 1 statutory deadline. On June 1 he issued regulations which provided an interim fixed program participation term for each member of the 8(a) portfolio through November 30, 1981. Eventually, they would remain in the program for that period of time provided they signed a statement that said they would agree to a date for ending their participation in the program.

On the same day, June 1, he proposed in the Federal Register graduation regulations which presumably would be in effect at least 60 days prior to November 30, because under his proposed regulations the firms are permitted 60 days to come up with business plans in response to the final program completion criteria regulations.

The regulations also appear to provide, however, that if a firm cannot agree to a fixed program participation term by November 30 and the interim one expires on November 30, they cannot be given a contract. Well, if the regulations, the preparation of business plans and the program completion negotiations are not completed by November 30, there can be no negotiation of graduation duties. There can be no new fixed program participation term, and the interim one will expire.

In other words, we will be exactly where we were on June 1 on November 30, unless SBA provides another leeway period, which the current proposal does not include.

What I fear may happen is as follows: SBA comes up with graduation regulations. The ones they have proposed do not give firms an ability to adopt a business plan and come up with a blueprint for knowing when they will be completed, because the proposals don't provide criteria such as debt to equity ratio, ability to obtain long- and short-term financing, or percentage of operating expenses to total overhead compared to other non-8(a) firms so that a firm can measure its performance. Firms will be in disarray in terms of how to prepare their business plans, but even if they do, SBA will have negotiations, and say, "Here you have 1 or 2 years, and if you don't agree, since your interim one lapses on November 30, you are out." I fear take it or leave it negotiations, which I don't perceive to be good faith negotiations which Congress anticipated when it drafted Public Law 96-481.

These letters asking firms to sign proposed interim dates are out. The proposed regulations are out, and firms are in a quandary. I will provide a copy of this letter to the committee.

[Information referred to above follows:]

SMALL BUSINESS ADMININSTRATION,
Washington, D.C., June 1, 1981.

IMPORTANT NOTICE TO ALL CURRENTLY ELIGIBLE 8(a) FIRMS

Under Public Law 96-481 (October 21, 1980), every small concern operating under the Section 8(a) Program must have a fixed period of time (Fixed Program Participation Term) to remain in the program. The statute also provided that no Section 8(a) contracts may be awarded to a concern after June 1, 1981, unless the concern has such a Fixed Program Participation Term in its business plan.

In implementing this statutory directive, the Small Business Admininstration has published in the Federal Register a Notice of Proposed Rulemaking setting forth the criteria and procedures for establishing Fixed Program Participation Terms for Section 8(a) concerns. A copy of this Notice of Proposed Rulemaking is enclosed herein. As noted therein, comments will be received by SBA on this proposal for 60 days following the Federal Register publication date.

Since the statute prohibits the award of Section 8(a) contracts after June 1, 1981, unless a Fixed Program Participation Term is in place, and the above-noted proposed regulations will not be effective (as proposed or as revised after receipt of comments) until after that data, SBA has also promulgated an interim regulation (13 C.F.R. § 124.1-1(g)), effective upon publication in the Federal Register, which authorizes the acceptance by SBA of a temporary Fixed Program Participation Term for a period not extending beyond November 30, 1981. A copy of this regulation is also enclosed. Sometime prior to November 30, 1981, the final regulation implementing the statutory requirements will be adopted. Under this final regulation, each small concern must negotiate a permanent Fixed Program Participation Term with SBA in order to remain eligible for the award of Section 8(a) contracts and other program benefits.

Accordingly, under the referenced interim regulation, SBA hereby offers your company a temporary Fixed Program Participation Term in your business plan for a period not extending beyond November 30, 1981. If you wish to accept such a temporary Fixed Program Participation Term, please designate the desired period of time (not extending beyond November 30, 1981) and have the authorization company official sign in the place indicated at the end of this letter and return the letter to your local SBA District Office within ten (10) calendar days. Your temporary Fixed Program Participation Term will thereupon be effective upon receipt by SBA. If you do not accept this temporary Fixed Program Participation Term, a permanent Fixed Program Participation Term may be negotiated with SBA upon adoption of the final regulations. You should be aware, however, that no Section 8(a) contracts may be awarded your concern after June 1, 1981, until a Fixed Program Participation Term is established for your concern.

Please note that, notwithstanding anything to the contrary herein, the regulations specifically provide that the establishment of a Fixed Program Participation Term does not limit SBA from initiating Termination or Completion actions during any Fixed Program Participation Term.

Thank you for your prompt attention to this matter.

Sincerely,

ROBERT L. WRIGHT, Jr.,
Assistant Admininstrator.

A temporary Fixed Program Participation Term ending ——— (not extending beyond November 30, 1981) is hereby accepted.

——— Company Name
——— Authorizing Official
——— Date

To be returned to your local SBA District Office.

Mr. MITCHELL. The alleged violations of due process might well be handled in the courts by those firms that are capable of handling them. There are other firms that simply cannot go into litigation.

What recommendations would you make to this subcommittee to block the alleged violations of due process? What specific recommendations could you give me?

Mr. LEPOW. Relative to the issue of program completion and recent regulations, SBA should be directed to immediately inform all 8(a) firms that if they agree to an interim fixed program participation date of November 30, they are not estopped from getting continued program support beyond that date, even if they have not been able to agree to a graduation date because SBA's regulations are not yet final and their business plans have not been submitted.

That directive should go forth from SBA to 8(a) firms immediately, because if firms do not sign the letter which SBA is sending to them, they can't get contracts.

You have got blackmail again. Relative to the issues of——

Mr. MITCHELL. With reference to your first recommendation, after consulting with the members of this committee, and if they would approve it, I would think that the committee could get such a letter firmly recommending that this be done. I am not at all sure that, due to the separation between the executive and the legislative branch, that we can mandate that it be done.

Mr. BAKER. I would like to ask a question.

Even though SBA has been mandated to do certain things by statute, this committee has oversight powers. Seemingly if SBA is in violation there is nothing the committee itself could do?

Mr. MITCHELL. I certainly want counsel to look at this problem area, and I am certain that there are some remedies. From the top of my head, the reference to the first problem, that is about the extent of where we can go; but if indeed there are other remedies or actions available to us, we will certainly avail ourselves of them.

Mr. LEPOW. On the issue of apparent de facto terminations of firms for alleged size violations, there are firms who have negotiated contracts with procuring agencies, payment and pricing terms have been agreed to, and they merely await the ministerial act of signing by SBA, but they are not signing because the firm might be large. SBA should be immediately directed to process contracts for firms until those firms have been terminated. These firms have not been terminated, and many of them don't even know why their contracts are being frozen. The contract flow must be established.

We can provide names of firms with this problem, and SBA should be made to account for why those contracts are not being processed.

[Affidavits marked as "Testimony References" (part of the record in *Amex Systems, Inc.* v. *Cardenas,* Civ. No. 81-1223, filed May 27, 1981) follow:]

TESTIMONY REFERENCES

IN THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF COLUMBIA

(Civil Action No. ——)

UNITED SERVICES, INC., ET AL., PLAINTIFFS,

v.

MICHAEL CARDENAS, ADMINISTRATOR, SMALL BUSINESS ADMINISTRATION, DEFENDANT

AFFIDAVIT OF IRREPARABLE INJURY

Raymond A. Mott, being duly sworn, deposes and says:

1. I am President and principal owner of Raven Systems and Research, Inc. of Washington, D.C. ("Raven"), a Plaintiff in the above-entitled action. In this capacity, I am in a position to state the effect upon Raven of its *de facto* suspension from participation in the Small Business Administration's ("SBA's") 8(a) Procurement Program.

2. Recent action by the SBA threatens such a *de facto* suspension of Raven from this program. On May 1, 1981, Michael Cardenas, Administrator, SBA issued a directive naming 46 firms as subject to immediate size eligibility review. Raven was listed as one of those firms. (A copy of this notice is attached.) This notice states that firms found too large for 8(a) program eligibility would be immediately subject to termination from the program or completion proceedings. The directive also ordered Government Contracting Officers to forward details regarding prospective procurement awards to firms on the list that may be found too large for continued 8(a) program eligibility, along with names of alternative 8(a) firms, to the Associate Administrator, Minority Small Business/Ca;ital Ownership Development for review. The SBA issued a contemporaneous press release (SBA Number 81-25) which quoted extensively from the directive and also listed the firms, including Raven, subject to size review. (See attachment.)

3. The wide publicity afforded the SBA directive, and the notoriety this directive focused on Raven, because of its inclusion in the list of firms subject to the directive, has already done substantial damage to Raven's business prospects. And, if the SBA carries out the directive, it will do irreparable harm and damage to Raven.

4. Raven has already suffered substantial damage as a result of the SBA directive. The information processing field is dominated by large well established nationwide firms who have a competitive advantage over firms such as Raven. Raven is only now reaching a scale of operations that permits it to offer the diversity of services necessary for it to be competitive in the market at large. Raven, however, is still highly reliant upon 8(a) procurements for the major portion of its work. Raven, like other firms, must continually negotiate the prospective contracts in order to keep the flow of work steady. Thus, if government agencies in the 8(a) program refuse to negotiate with certain 8(a) firms, the steady flow of work necessary to sustain a business is interrupted. Moreover, without the oportunity to plan for a gradual decrease in 8(a) procurements, firms such as Raven are not able to fund bidding and proposing costs for non-8(a) contracts to take the place of 8(a) awards. As a result of the May 1, 1981 directive, Raven has begun to experience this phenomenon. For example, procurement officials at the Department of Interior have already refused to continue ongoing 8(a) contract negotiations or to enter into new negotiations with deponent's company. (See affidavit of Marian Stokes.)

5. In addition, Defendant's actions constitute an imminent threat of further irreparable injury to the company. Unless Defendant's directive of May 1, 1981 is enjoined, Raven will be subject to an immediate graduation from the 8(a) program without the opportunity to plan for an orderly transition from reliance upon less

competitive 8(a) procurements to more competitive procurements which are open to all contractors. The sudden withdrawal of Raven's eligibility for 8(a) procurements awards will likely cause sales for the firm to drop from a current level of $7.5 million annually for FY 1981 to approximately $800,000 total for FY 1982. (See attachment.) Should such a drop in sales occur, Raven would have to furlough many competent employees. The loss of competent employees, as SBA's action imminently threatens, would cause Raven to suffer irreparable injury. Even if a later court decision held SBA's action illegal (or if SBA were to retract its directive voluntarily in the future), Raven would have no way of regaining the competent staff whose loss the SBA directive now threatens. It would take three to five years, in my estimate, to rehire and retrain such a staff. In view of the costs of rehiring and retraining staff to their present level, and the excess overhead expense which would necessarily be incurred as Raven scaled back its operations, I conclude that the SBA directive would plainly threaten Raven with dissolution.

6. In September 1978, the SBA provided a $517,000 loan guarantee to Raven. Payments on the loan, which bears interest at 3% over prime, since the inception of the loan have been current. The outstanding balance on the loan is approximately $300,000. Defendant's actions and the concomitant loss in sales, seriously impair Raven's ability to make payments on this loan. Default on the loan will adversely affect Raven's credit rating, and might result in SBA's eventual liability on the loan.

7. Defendant's failure to implement regulations pursuant to the Small Business Act, as amended in 1978, under which guidelines for graduation plans were set forth, has impeded Raven's progress toward establishing a fixed date for graduation from the 8(a) program. Defendant's failure to enact said regulations for firms in the program has caused Raven to rely to its detriment upon its continued participation in the program. Had the regulations mandated by PL 96-481 been implemented in a timely manner, with SBA assistance, Raven would have developed a plan for a gradual phase out from the 8(a) program and would have established a fixed graduation date.

8. Plaintiffs have no adequate remedy at law.

9. Defendant will suffer minimal harm if the 8(a) program size review directive is enjoined. Pursuant to the regulations that must be issued under PL 96-481, Raven and the other firms listed in the directive will develop plans for the gradual phase out and ultimate graduation from the 8(a) program. The orderly phase out of firms who reach their graduation dates will achieve the Defendant's objective of making room in the 8(a) program for new entrants, albeit over a longer period of time than would the immediate termination or competition of such firms.

10. The public interest will be served by enjoining the defendant from requiring prospective procurement awards to be made subject to approval of the Associate Administrator and from instituting immediate termination or completion proceedings where firms are found to be large. Both protracted procurement review and immediate termination or completion proceedings without the opportunity for an orderly phase out from the program have the effect of weakening successful minority firms such as deponent's company—firms that have developed as a result of a substantial investment of government funds. It is therefore in the public interest to block these actions.

RAYMOND A. MOTT,
President, Raven Systems & Research, Inc.

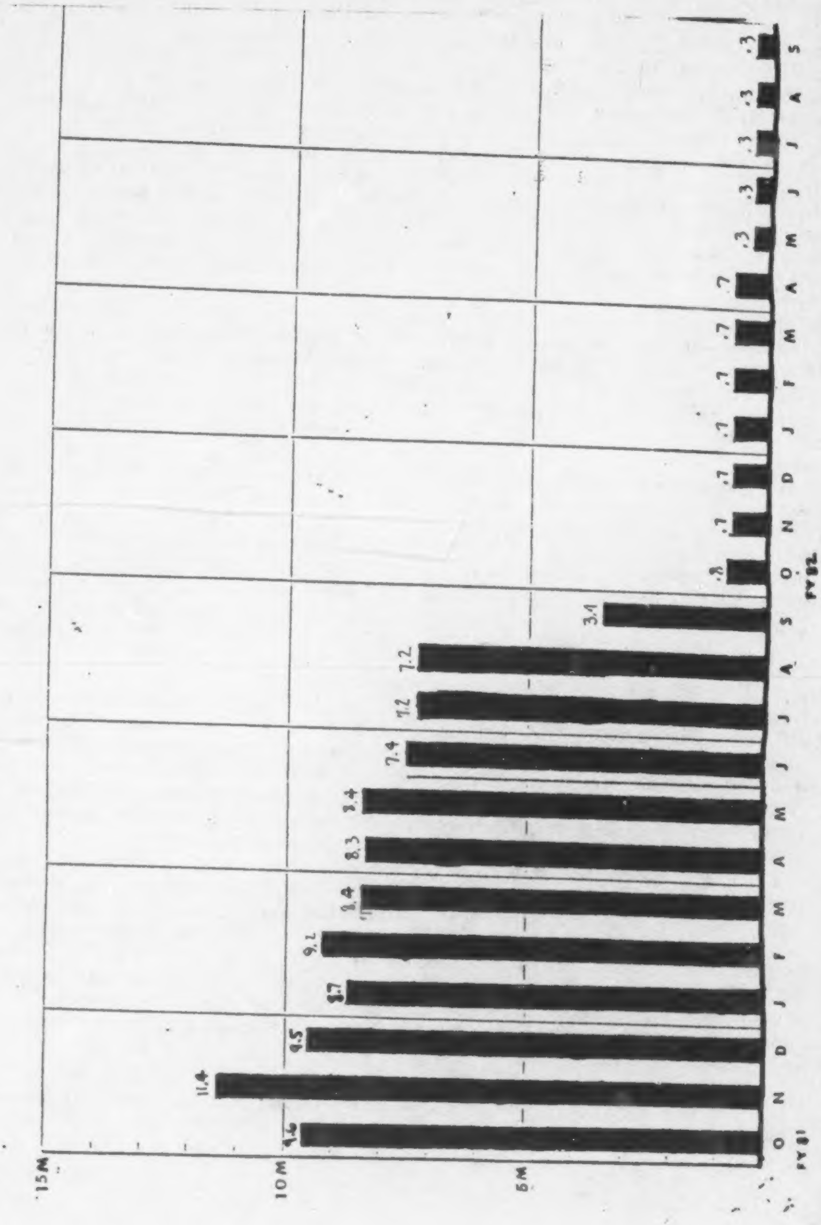
District of Columbia ss:
Subscribed and sworn to before me this 21st day of May, 1981.

——— ———,
Notary Public.

My commission expires: July 3, 1982.

Attachments referred to in paragraph 2 of the affidavit are appended to the complaint and marked "Exhibit A".

SALES - ANNUALIZED



BEST COPY AVAILABLE

In the United States District Court for the District of Columbia

(Civil Action No. ———)

United Services, Inc., et al., plaintiffs,

v.

Michael Cardenas, Administrator, Small Business Administration, defendant

AFFIDAVIT OF MARIAN STOKES

Marian Stokes, being duly sworn, deposes and says:

1. I am General Services Manager of Raven Systems and Research, Inc., of Washington, D.C. As a member of the Raven management group, I am responsible for Raven's marketing at the U.S. Department of Interior.

2. On the morning of May 7, 1981, I received a telephone call from Marrie Chavis, Small Business Representative for the Office of Surface Mining, U.S. Department of the Interior, regarding prospective contracts that Raven might negotiate with the Department of Interior.

3. Ms. Chavis said that she wanted to consider contracting with Raven for a work processing task, but that entering into such a contract would be difficult if not impossible because of the "red tape" resulting from the May 1, 1981 directive of Michael Cardenas, Administrator of the Small Business Administration ("SBA").

4. Ms. Chavis indicated that she was aware that Raven had been included among the forty-six firms who no longer qualify for the 8(a) program. Thus, Ms. Chavis stated, if Raven was in fact found to be ineligible for the program, too much time would be lost by the Interior Department in attempting to meet the SBA guidelines for processing contracts with firms found to be ineligible.

5. Ms. Chavis also stated that those firms identified in the May 1, 1981 directive would have difficulty obtaining additional contracts at DOE.

6. Ms. Chavis inquired as to whether Raven had received any notification of their graduation from the 8(a) program or a copy of the directive, I responded that Raven had not received any notification of graduation and had not received a copy of the directive. She agreed to give me a copy of the directive, which was later provided.

Further, affiant says nothing.

Marian Stokes.

District of Columbia ss:

Subscribed and sworn before me this 22nd day of May, 1981.

——— ———, *Notary Public.*

My commission expires: February 14, 1981.

In the United States District Court for the District of Columbia

(Civil Action No. ——)

OAO Corporation, plaintiff,

v.

Michael Cardenas and the Small Business Administration, defendant

AFFIDAVIT OF IRREPARABLE INJURY

Cecil Barker, being duly sworn, deposes and says:

1. I am President and principal owner of OAO Corporation, of Maryland, a Plaintiff in the above-entitled action. In this capacity, I am in a position to state the effect upon OAO Corporation of its de facto suspension from participation in the Small Business Administration's ("SBA") 8(a) Procurement Program.

2. OAO Corporation was one of 46 firms named in an SBA directive of May 1, 1981, issued by Michael Cardenas, Administrator, as subject to immediate size eligibility review. (A copy of this notice is attached). This notice stated that firms found too large for 8(a) program eligibility would be immediately subject to termination from the program or completion proceedings. It was further ordered that any prospective procurement awards to firms found too large for 8(a) firms must be referred to the Associate Administrator, Minority Small Business/Capital Ownership Development for review. (See Attachment) The SBA issued a contemporaneous

press release (SBA Number 81-25) which quoted extensively from the directive and also listed the firms, including OAO Corporation, subject to size review. (See Attachment)

3. The wide publicity afforded the SBA directive, and the notoriety this directive focused on OAO Corporation, because of its inclusion in the list of firms subject to the directive, has already done substantial damage to OAO Corporation business prospects. And, if the SBA carries out the contents of the Directive, it will do irreparable harm and damage to OAO Corporation, our company.

4. OAO Corporation has already suffered substantial damage as a result of the SBA directive. The field of reserach and development and other services on or for guided missiles and space vehicles is dominated by large well established nationwide firms who have a competitive advantage over firms such as ours. OAO Corporation is only now reaching scale of operations that permits it to offer the diversity of services necessary for it to be competitive in the market at large. OAO Corporation however, is still highly reliant upon 8(a) procurements for the major portion of its work. OAO Corporation, like other firms, must continually negotiate for prospective contracts in order to keep the flow of work steady. Thus, if government agencies in the 8(a) program refuse to negotiate with certain 8(a) firms, the steady flow of work necessary to sustain a business is interrupted. Moreover, without the opportunity to plan for a gradual decrease in 8(a) procurements, firms such as OAO Corporation are not able to fund bidding and proposing costs for non-8(a) contracts to take the place of 8(a) awards—(bidding and proposing cost for 8(a) programs to date amount to approximately $750,000, (See Briefing Affidavit)). As a result of the May 1, 1981 directive, OAO Corporation has begun to experience this phenomenon. For example, procurement officials at the Drug Enforcement Agency have refused to negotiate the contract awarded deponent's company. The same is true of procurement officials at NASA, the U.S. Coast Guard and the Air Force. (See Briefing Affidavit)

5. In addition, Defendant's actions constitute an imminent threat of further irreparable injury to the company. Unless Defendant's directive of May 1, 1981 is enjoined, OAO Corporation will be subject to an immediate graduation from the 8(a) program without the opportunity to plan for an orderly transition from reliance upon less competitive 8(a) procurements to more competitive procurements which are open to all contractors. The sudden withdrawal of OAO Corporation's eligibility for 8(a) procurement awards will likely cause sales for the firm to drop approximately 45 percent for fiscal year 1981. Should such a drop in sales occur, OAO Corporation would have to furlough many competent emloyees. The loss of competent employees, as SBA's action imminently threatens, would cause OAO Corporation to suffer irreparable injury. Even if a later court decision held SBA's action illegal (or if SBA were to retract its directive voluntarily in the future), OAO Corporation would have no way of regaining the competent staff whose loss the SBA directive now threatens. It would take three to five years, at least, to rehire and retrain such a staff. In view of the costs of rehiring and retraining staff to their present level, and the excess overhead expense which would necessarily be incurred as OAO Corporation scaled back its operations, I conclude that the SBA directive would plainly threaten OAO Corporation with dissolution.

6. The SBA has provided a $350,000 loan guarantee to OAO Corporation. Payments on the loan since its inception have been current and bear interest at 3 percent over prime. The outstanding balance on the loan is approximately $153,370. Defendants actions and the concommitant loss in sales, seriously impair OAO Corporation's ability to make payments on this loan. Default on the loan will adversely affect OAO Corporation's credit rating, and will result in SBA's eventual liability on the loan.

7. Defendant's failure to implement regulations pursuant to Public Law 94-481, under which guidelines for graduation plans were set forth, has impeded OAO Corporation progress toward establishing a fixed date for graduation from the 8(a) program. Defendants' failure to enact said regulations for firms in the program has caused OAO Corporation to rely to its detriment upon its continued participation in the program.

8. Plaintiffs have no adequate remedy at law.

9. Defendants will suffer minimal harm if the 8(a) program size review directive is enjoined. An equitable allocation of prospective 8(a) contacts can be made to other eligible firms through the gradual phase out of firms that, under a legal and rational application of the size eligibility criteria, are found to be too large.

10. The public interest will be served by enjoining defendants from requiring prospective procurement awards to be made subject to approval of the Associate Administrator and from instituting immediate terminaton or completion proceedings where firms are found to be large. Both protracted procurement review and immediate termination or completion proceeding without the opportunity for an

orderly phase out from the program have the effect of weakening successful minority firms such as depoenent's company—firms that have developed as a result of a substantial investment of government funds. It is therefore in the public interest to block these actions.

11. The Affidavit is made in support of Plaintiff's Complaint fo- Injunctive Relief contained herein.

Cecil Barker,
President, OAO Corp.

Subscribed and sworn to before me this —— day of ———, 1981.
My Commission Expires:

——— ———, *Notary Public.*

Attachments referred to in paragraph 2 of the affidavit are appended to the complaint and marked "Exhibit A".

BRIEFING AFFIDAVIT

The recent actions by the Small Business Administration (SBA) would seriously jeopardize OAO Corporation in the following ways.

1. OAO was recommended by SBA for an 8 (a) competition with the Drug Enforcement Agency (DEA). The agency (DEA) selected OAO as the winner. The estimated cost of this contract is $100,000. SBA has told DEA that it cannot negotiate with OAO and the award should be made to another 8(a) company. The contracting officer, Mr. Arnold Singer, (202) 633-1145 finds this to be unacceptable. The experience from this contract, the potential for follow-on contracts with DEA and the potential for future contracts of this type are all lost due to SBA's actions, with the damages to OAO running into the hundreds of thousands of dollars.

2. OAO was recommended by SBA to the NASA/GSFC for an 8(a) competitive procurement. OAO attended an 8(a) preproposal conference at the GSFC with several other 8(a) firms. Of the many 8(a) firms solicited by NASA only four responded to the RFP. OAO was selected as the winner by NASA/GSFC. The estimated value of this procurement is $8 million dollars over five years. OAO stands to lose this procurement because of SBA's new policy. OAO incurred over $37,000 in B&P funds in the preparation and submission of this proposal. Damages in this case are in the millions of dollars.

3. OAO has participated in an 8(a) competition at DOT/TSC in Boston, Massachusetts. OAO was selected originally as the winner. However, SBA told TSC it could not negotiate with OAO and the procurement would have to be recompeted. OAO is now one of three finalists for the new competition. OAO is again being ruled out due to SBA's actions. Estimated value is $5 million dollars over three years.

4. The U.S. Coast Guard has selected OAO for a $2 million award after evaluating several 8(a) firms. Once again SBA's action precludes this award.

5. The Air Force has selected OAO for a Basic Ordering Agreement 8(a) contract. SBA will not approve their request to negotiate with OAO. Estimated value is $5 million.

6. EPA has selected OAO for a $426,960 contract that SBA has not processed the paperwork nor given EPA permission to negotiate with OAO.

7. There are several follow-on contracts and new procurements that OAO has marketed which OAO will now be denied access to because of SBA's actions. The cumulative value of these potential awards is $57 million.

8. There are two other procurements frozen by SBA. The estimated values are $62,882 for the Department of Energy and $43,307 for the Defense Systems Division, Naval Ocean System Command.

9. SBA's action has forced OAO to lay off seven (7) employees to date. If this action is allowed to stand, OAO will have to lay off approximately 125 people over the next three (3) months. The net result of this is to drive the company into insolvency. In addition, many of the employees laid off will be minorities.

11. OAO presently has a $350,000 SBA guaranteed loan. SBA's action will certainly result in OAO's inability to repay the remainder of the loan. This will then place the liability on SBA for the unpaid balance.

12. OAO's marketing and B&P costs associated with procurements impacted by SBA's decision amount to approximately $750,000 of incurred expenses to-date. These costs must be recoverable by OAO.

UNITED STATES DISTRICT COURT FOR THE DISTRICT OF COLUMBIA

(C.A. No. ——)

UNIFIED INDUSTRIES, INC., PLAINTIFF,

v.

MICHAEL CARDENAS, ADMINISTRATOR, SMALL BUSINESS ADMINISTRATION, DEFENDANT

AFFIDAVIT OF IRREPARABLE INJURY

Theodore A. Adams, Jr., being duly sworn, deposes and says:

1. I am President and Chief Executive Officer of Unified Industries Incorporated (UII) a Delaware corporation with its principal place of business in Springfield, Virginia, a Plaintiff in the above-entitled action. In this capacity, I am in a position to state the effect upon UII of its *de facto* suspension from participation in the Small Business Administration ("SBS") 8(a) Procurement Program.

2. Unified Industries Incorporated was one of 46 firms named in an SBA directive of May 1, 1981, issued by Michael Cardenas, Administrator, as subject to immediate size eligibility review. (A copy of this notice is attached.) This notice states that firms found too large for 8(a) program eligibility would be immediately subject to termination from the program or completion proceedings. It was further ordered that any prospective awards to firms found too large for 8(a) firms be brought to the attention of the Associate Administrator, Minority Small Business/Capital Ownership Development for review. (See Attachment.) The SBA issued a contemporaneous press release (SBA No. 81-25) which quoted extensively from the directive and also listed the firms, including UII, subject to size review. (See Attachment.)

3. The wide publicity afforded the SBA directive, and the notoriety this directive focused on UII, because of its inclusion in the list of firms subject to the directive, has already done substantial damage to UII business prospects. And, if the SBA carries out the contents of the directive, it will do irreparable harm and damage to UII, our company.

4. With respect to the substantial damage UII has already suffered, as a result of this directive, see the details set out in the attached Affidavit of Theodore A. Adams, Jr.

5. Unless defendant's directive of May 1, 1981 is enjoined deponent will be subject to an immediate graduation from the 8(a) program without the opportunity to plan for an orderly transition from reliance upon 8(a) procurements to becoming a fully competitive firm. The immediate withdrawal of 8(a) procurement awards will cause sales for the firm to drop from a current level of $7 million annually for FY 1981 to approximately $2 million total for FY 1982. If UII were graduated from the 8(a) program at this time it would:

(a) cause the layoff of 70 to 75 percent of its employees immediately upon the cancellation of those contracts;

(b) cause the cancellation of leases with respect to office space in an approximate amount of over one-half million dollars;

(c) cause the overhead as compared to the sales to increase dramatically, approximately 500 percent.

(d) substantially reduce taxes to jurisdictions in which the company operates;

(e) adversely affect the company's ability to market in non-8(a) areas, since contract termination generally gives the impression that work is not being performed satisfactorily;

(f) virtually destroy the credibility and goodwill established and developed over the period of the company's existence;

(g) destroy established and on-going banking relationships with private financial institutions;

(h) limit the company's ability to meet its financial obligations to creditors;

(i) discontinue the benefits provided to employees such as health insurance, life insurance and other fringe benefits; and

(j) give the impression to the general public and potential customers that the company has heretofore conducted its business in an illegal or unethical fashion.

6. Defendant's failure to implement regulations pursuant to Pub. L. No. 96-481, under which guidelines for graduation plans were set forth, has impeded UII progress toward establishing a fixed date for graduation from the 8(a) program. Defendant's failure to enact said regulations for firms in the program has caused UII to rely to its detriment upon its continued participation in the program.

7. Plaintiffs have no adequate remedy at law.

8. Defendants will suffer minimal harm if the 8(a) program size review directive is enjoined. An equitable allocation of prospective 8(a) contacts can be made to other eligible firms through the gradual phase out of firms that, under a legal and rational application of the size eligiblity criteria, are found to be too large.

9. The public interest will be served by enjoining defendants from requiring prospective procurement awards to be made subject to approval of the Associate Administrator and from instituting immediate termination or completion proceedings where firms are found to be large. Both protracted procurement review and immediate termination or completion proceedings without the opportunity for an orderly phase out from the program have the effect of weakening successful minority firms such as deponent's company—firms that have developed as a result of a substantial investment of government funds. It is therefore in the public interest to block these actions.

10. This affidavit is made in support of Plaintiff's Complaint for Injunctive Relief contained herein.

THEODORE A. ADAMS, Jr.,
President, Unified Industries, Inc.

District of Columbia, ss:
Subscribed and sworn to before me this —— day of ——, 1981.
—— ——, *Notary.*

My Commission expires:

Attachments referred to in paragraph 2 of the affidavit are appended to the complaint and marked "Exhibit A".

IN THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF COLUMBIA

(Civil Action No. ——)

AMEX SYSTEMS, INC., ET AL., PLAINTIFF,

v.

MICHAEL CARDENAS, DEFENDANT

AFFIDAVIT OF THEODORE A. ADAMS, JR.

Theodore A. Adams, Jr., being duly sworn, deposes and says:

1. I am President and Chief Executive Officer of Unified Industries Incorporated (UII) a Delaware corporation with its principal place of business in Springfield, Virginia.

2. As President of UII, I am responsible for the overall operation of the company to include operations, marketing, administration and all other aspects of the business. In carrying out this responsibility, I have delegated major areas of responsibility to my two Executive Vice Presidents who report directly to me.

3. Since the issuance of the May 1, 1981 SBA News Release referred to in paragraph 10, page 4 of the Complaint herein, UII, as one of the 8(a) certified firms referred to as "The 50 Largest Companies in SBA's 8(a) Procurement Program" has suffered serious and irreparable injury in its servicing or marketing relationships with government agencies, in its subcontracts with the national, regional and district SBA offices, and in the eyes of the public at large.

4. UII was listed as number 7 on the aforementioned list and reported to have been awarded $73,271,755 in contracts since its entry into the 8(a) program through September 30, 1980. The $73,271,755 does not represent actual sales and its therefore misleading. UII was awarded its first contract under the 8(a) program in May 1973. Since that time, UII has had total sales of $33 million. In 1980, UII was awarded a $36 million contract from the Office of the Federal Inspector to conduct design review and quality control of the construction of the Alaskan Natural Gas Pipeline. This contract produced $1.4 million in sales in fiscal year 1980 for UII. The remainder of the contract is scheduled to be performed over the next four or more years. The performance of the contract is contingent upon the ability of a consortium of energy related companies to raise the necessary capital to construct the natural gas pipeline across Alaska and Canada. To date, the financing from private sources has not materialized. Accordingly, it is misleading to state the overall contract award as opposed to "gross sales".

5. While the SBA Administrator may be aware that the $73 million in contract awards do not represent actual sales, it is doubtful that personnel in all regional

offices is aware of that fact. It is a certainty that the federal agencies with whom UII deals are not aware of this discrepancy.

6. The issuance of the May 1, 1981 News Release has caused the following specific incidents to occur with respect to UII:

A. On or about May 15, 1981, the Department of Energy (DOE) contacted the SBA Central Office in Washington for the purpose of obtaining its approval to enter into negotiations with UII to conduct audits in various locations throughout the country. SBA advised DOE that UII was currently beign considered for termination from the 8(a) program, therefore, DOE should enter into negotiations with UII for a non-competitive award of the aforementioned contract.

B. On or about May 15, 1981, it came to my attention that the SBA had refused to execute a sub-contract with UII with respect to contracts SBA has entered into with the Department of Army that had been set aside for UII. Specifically, UII has participated in and completed contract negotiations with the Department of Army and the SBA for the award and sub-contract of certain Maintenance Engineering Support for Equipment-Systems under Contract Nos. DAAB07-81-D-6301 and 6302 between the Army and SBA, and Procurement ID No. (PIIN) SB3-4-0-8(a)81-C-1702 and 1705. After the issuance of the May 1, 1981 directive of the SBA Administrator announcing new tough policies for 8(a) program, the SBA Washington District Office refused to execute the award of the sub-contract to UII. (The sub-contract had already been signed by UII and merely needed the signature of the SBA District Director.) The reasons given for the SBA's refusal to execute the sub-contract was that the District Director has been advised not to issue any further sub-contracts to firms listed among "The 50 Largest Companies in SBA's 8(a) Procurement Program". The discontinuance of these awards was based upon paragraph 2 on page 2 or the May 1 directive. To date, that sub-contract has not been awarded to UII.

7. Further, UII has suffered the general effects that inure from the publication of such documents. Specifically, the agencies with whom UII does business have conveyed to certain members of the UII staff that they had read reports of the SBA Director's directive and questioned whether UII would be able to accept follow-on work with respect to contracts that UII currently has in-house. This obviously has a far-reaching adverse impact on our business.

8. Moreover, UII presently subcontracts with majority contractors who have prime contracts with the federal government. The publication of the SBA Administrator's confusing directive in major newspapers across the country, the airing of same on national and local television and radio caused these contractors to question whether UII could continue doing business with them. Ther implications of the directive left these contractors believing together UII was no longer a small business as defined by the SBA rules and regulations.

9. Additionally, UII, through its officers and staff has received hundreds of inquiries as to the meaning of the widespread publicity it has received and whether UII was going out of business. This adversely affects UII's ability to continue its non-8(a) marketing and gives the impression that the company is less than viable.

10. Finally, the widespread publicity has an adverse effect on the morale of the company's employees. Many of the company's essential employees who are assigned directly to contract line items have questioned the security of their jobs.

11. The overall effect of all of the above creates negative and adverse effects that exceed the immediate implications of the SBA Director's misleading publication.

Further, affiant says nothing.

THEODORE A. ADAMS, Jr.

District of Columbia ss:
Subscribed and sworn to before me this——day of———, 1981.
——— ———, *Notary Public.*

Mr. **MITCHELL.** I don't know whether you were here earlier when I expressed my grave concern that any agency of Government, including SBA, would consider itself to be acting with impunity in violation of some directives given to that agency of Government by the Congress. I mentioned in my opening statement I have a great deal of concern about the interim regulations, because I think they thwart what we attempted to do when Mr. Cardenas appeared before this committee, and I also think we have exceeding difficulty in accepting graduation based upon size standards, when in the last session of Congress this very committee rejected the size standards proposed by the Small Business Administration and said come back and bring us some more realistic ones.

I share from a different perspective in part your concern about the actions being taken by the Administrator, and I assure you that we will do all within our power to prevent any capricious and arbitrary action from being implemented.

Mr. LEPOW. I appreciate it.

Mr. BAKER. I am sorry some of the other members of the committee are not here, and I think you share what I am getting ready to state.

I am very sick and tired of the minority 8(a) firms being accused of all the abuses, when we know that 96 percent of all the abuses occur within the administration of the 8(a) program itself.

The blame should be placed where it belongs.

Mr. MITCHELL. All right. I thank you for your statement. This whole business, let me do it another way. In order to get something passed on the floor of the House, it is facilitated if a Member stands up and says that there is waste, fraud, and abuse. Those are the new code words, and if you do that loudly and frequently enough, generally you can attack programs.

Of course, I have said before, I am sure that there is some mismanagement and abuse in the 8(a) program just as some exists in the Congress, but I am certain that these code words have been exploited and utilized in an attempt to destroy the program.

Mr. LEPOW. Congressman Smith asked what are some of the positive reforms that have been adopted by SBA and you, Mr. Chairman, answered him quite correctly.

There are a few things that I would also like him to be apprised of, however. There were problems with eligibility criteria. Those criteria were strengthened by the Congress in 95-507. Senator Chiles held hearings on abuses. There were problems with advanced payments. SBA has adopted Federal Reserve Board letter of credit advance payment procedures. There were problems with business development expenses and SBA has developed new BDE procedures.

One of the remaining issues is graduation, and Congress has directed SBA to develop regulations based on criteria which addresses a variety of factors. SBA is now coming out with regulations.

Congressman Daub and Congressman Hiler are concerned that a select elite group of 8(a) participants is pirating away with all of the procurements. Based on GAO data, 8(a) represents approximately 1.8 percent of all Federal procurement dollars. You could expand the program and let everybody in. There is enough room.

Mr. MITCHELL. One percent of all Federal dollars.

Less than 2 percent, and what was the total Federal procurement last year, in excess of $90 billion?

Mr. LEPOW. $90 billion.

Mr. MITCHELL. On that clarifying note we will thank you for your testimony, gentlemen.

Mr. BLACKISTONE. We would like to request permission to submit questions for the record.

Mr. MITCHELL. After we hear the last two witnesses, all Members will have the privilege of submitting additional questions for the witnesses.

[Additional question for N.A.B.M. and their answers follow:]

QUESTIONS FOR N.A.B.M.

1. On page 2 of your statement you express a belief that graduation regulations are needed but that SBA's proposed regulations are inflexible and not responsive to economic realities. However, you do not offer recommendations for alternative graduation guidelines.

A. In light of the acknowledged need for firms to move out of the program, what criteria should be used to establish when a business should be graduated?

B. Is it reasonable to expect that a business entering the 8(a) program should be able to identify those things (cash flow, equity, a track record, etc.) which are required in order to make it competitive and viable?

C. Do you believe that the business development plan is a suitable mechanism for establishing goals by which progress toward graduation can be measured? Why or why not?

2. Your testimony cited studies which show that the time needed for a small business to become competitive is moire than the three to five years proposed by SBA.

A. To what extent do these studies take into account the benefits received by firms participating in the 8(a) program?

B. To what extent is the time required for a business to become self-sufficient reduced because of the assistance received through the 8(a) program?

3. On page 5 of your statement you say "many firms are awarded contracts with inflated dollar values that far exceed the receipts actually recovered." Can you provide details of specific cases in which this has occurred?

4. You proposed that the 8(a) portion of a firm's business be eliminated or discontinued in making size determinations. You also note that this method of size calculation may be criticized for providing a disincentive for firms to seek non-8(a) commercial business. However, you contend that this disincentive is effectively precluded by the proposed graduation regulations, particularly proposed Section 124.1-1(f)(5). Do you agree that the proposals contained in this section should be implemented?

5. On page 8 of your statement you say that SBA is balking on processing 8(a) contracts to larger firms and that SBA has notified firms by phone that they are being terminated. Can you provide details of specific cases in this each of these has occurred?

6. A recent report by the General Accounting Office criticized SBA because it has failed to place emphasis on developing 8(a) participants into self-sufficient businesses. It noted that less than four percent of all firms admitted to the program have graduated from the program as self-sufficient businesses.

A. Do you agree that firms participating in the 8(a) program should be expected to progress toward self-sufficiency?

B. Several other witnesses testified that firms which do not make progress toward achieving self-sufficiency should be terminated. Do you agree? If not, then what should SBA do if an 8(a) participant is not making progress toward achieving self-sufficiency?

7. A. The General Accounting Office has recommended that 8(a) be restructured as a two-tier program. In the first tier, disadvantaged firms would enter the program with strict limitations imposed. Once a firm reaches its limit, it would move to a second tier in which it would compete for contracts with other minority firms. This would be similar to the small business set-aside program. The rationale for this proposal is that it enables 8(a) firms to make a gradual transition into the competitive market. What is your reaction to this proposal?

B. Another proposal is that SBA continue the current program, but graduate firms by reducing their 8(a) contract support over a period of several years. In effect, a ceiling could be imposed on the firm which would be reduced by a fixed percentage each year (possibly 25 percent) until it reached zero.

Do you feel that this would be an effective way to wean firms of their 8(a) support?

8. The GAO report concluded that "The limited program achievements have resulted because SBA is pursuing two competing goals: maintaining the volume of 8(a) contracts and developing competitive disadvantaged businesses." Considering the program's goal of developing competitive disadvantaged businesses, what measure of program performance do you recommend which will not compete with this

goal? Would it be useful to measure program success by the volume of government purchases from 8(a) graduates?

9. SBA has identified the lack of access to the program by eligible new firms as one of the serious problems which needs to be addressed. It appears unlikely that SBA will have additional resources available to enable it to expand the size of the program (in terms of the number of firms participating). In light of this, how would you recommend that SBA address this problem?

ANSWERS

1. A. SBA apparently considers a firm's performance while in the 8(a) Program to be the decisive factor in determining whether and at what time the firm should be "graduated." We believe that its resulting proposed regulations, with their emphasis on industry-wide maximum participaton terms and emphasis on a firm's past performance instead of future potential, are seriously inadequate.

As an examination of the legislative history of Public Law 96-481 indicates, Congress intended that SBA's graduation regulations would focus on the amount of time and support necessary to correct an individual firm's economic impairment. The Conference Report listed the following factors as among those the regulatons were to take into account: "the amount of SBA assistance needed to correct the impairment of 8(a) concerns, the individual characteristics of the 8(a) concern, the locale in which the firm conducts its business, the nature of the industry and the availability of private sector capital and procurement to assist the firm in achieving maturity in the American economic system." H. Conf. Rep. No. 1434, 96th Cong., 2d Sess. 16; 1980 U.S. Code Cong. & Ad. News 5005. *See also* S. Rep. No. 974, 96th Cong., 2d Sess. 23, 1980 U.S. Code Cong. & Ad. News 4975.

These factors, which predicate an 8(a) firm's future success in the American marketplace by comparing it with non-socially and economically disadvantaged firms, stand in stark contrast to SBA's proposed regulations, which ignore all of these factors and concentrate almost exclusively on the firm's performance within the 8(a) Program. We believe that this misdirected focus has resulted in regulations which are totally non-responsive to the congressional guidelines found in the legislative history.

In addition to the factors listed above, we believe the following factors must be considered in establishing graduation criteria:

1. the "learning curve" for small businesses in various industries. In other words, how much time does it take for a small business to gain sufficient knowledge to function independently and effectively;
2. ability to attract equity capital;
3. establishment of a track record with suppliers, creditors, procuring agencies, and commercial markets;
4. the extent to which economies of scale within an industry have been met;
5. sufficient cash in the business to bond in industries where bonding is required;
6. debt-to-equity ratio;
7. ability to obtain long- and short-term financing.

B. It is certainly reasonable to expect a firm to have sufficient knowledge of the industry which it is seeking to enter to recognize those things necessary for it to become competitive and viable. However, it may not be able to tell when entering the Program how much assistance over how long a period of time may be necessary to assist the firm to achieve competitive viability. This is a role which SBA should be able to fill, given the expertise it should have developed in administering the Program. However, SBA's past dereliction in monitoring the performance of 8(a) Program graduates has resulted in the total lack of any data base to use in making objective determinations of how much of what kind of assistance is necessary to enable an 8(a) participant to become competitively viable.

C. If both SBA and the 8(a) participant have sufficient knowledge of the industry and the individual firm's place within that industry, a business plan revised as SBA and the firm gain more experience should provide a suitable mechanism by which progress toward graduation can be measured. This assumes, of course, that helping firms achieve competitive viability remains the goal of the 8(a) Program. If another benchmark is used for "graduation," such as having received X number of years of contract support or Y number of dollars in Federal procurements, then business plans are not suitable mechanisms. However, we believe that, until and unless Congress chooses to change the purposes of the 8(a) Program, a business plan with goals and a reasonable timetable in which to attain them is a suitable mechanism for measuring progress toward competitive viability.

2. These studies examine non-socially and economically disadvantaged firms and indicate how long it takes for businesses not laboring under those handicaps to

become competitive. The 8(a) Program is designed to overcome these initial handicaps to help firms to gain the skills to overcome the additional hurdles faced by every small business, and to help them achieve competitive viability. Neither SBA nor any other study has quantified the "benefits received by firms participating in the 8(a) Program," other than Federal procurement contracts, much less how long any such benefits last once Program participation ceases. Therefore, it cannot be authoritatively stated how much participation in the 8(a) Program reduces the time needed to achieve competitive viability. Until such time as it can be, surely it is more in keeping with the goals of the 8(a) Program to err on the side of providing more support to economically and socially disadvantaged firms and create viable businesses than to provide too little support for too short a time and waste the federal money already invested in the firm.

3. The situation discussed during the Hearings Before the Task Force on Minority Enterprise of the Subcommittee on General Oversight and Minority Enterprise of the House Committee on Small Business, 96th Cong., 1st Sess. 54 (April 10, 1979), still persists today, in the petroleum products industry, among others.

4. We believe that the artificially injected 8(a) portion of a firm's business is certainly more appropriately considered in graduation proceedings than in size determination proceedings. However, while we agree that the extent to which a firm has worked to lessen its dependence on 8(a) contract support should be considered in graduation regulations, we believe that the proposals contained in § 124.1-1(f)(5) can be and must be improved. In their present form they do not take into account many important factors, including those Congress instructed SBA to take into account in its graduation regulations, besides the amount of 8(a) contract support which a firm has received. We would also like to reemphasize the point made in our testimony that SBA regulations already contain a provision under which 8(a) participants may be terminated for failure to, "reasonably pursue competitive and commercial business in accordance with its business plan, or failure to otherwise make reasonable efforts to achieve competitive status." 13 C.F.R. § 124.1-1(e)(1)(xiv). It is under this provision, rather than the size determination or graduation regulations, that SBA can most effectively move against firms which have over-relied on the 8(a) Program.

5. In response to the first part of your question, please see the materials marked as "Testimony References 1, 3, 6" and submitted to the Subcommittee with these answers. In reference to the second question, upon checking with the firm which had claimed to have received such a phone termination, we have found that our earlier information was mistaken. We have modified our statement for the record accordingly.

6. We would agree that firms within the 8(a) Program should progress toward self-sufficiency. Standards against which a firm's progress can be measured must be established. Termination should not be SBA's first and only remedy for firms which fail to progress toward achieving self-sufficiency or competitive viability. We believe that SBA should keep much closer tabs on firms within the Program so that it will know early on whether or not a firm is having problems in achieving these goals. If these problems are detected at an early stage, they can be corrected and a firm set back on the right track through assistance tailored to the specific problems. If the problems persist, then termination should certainly remain an option open to SBA.

7. A. We agree with the concept of a tiered program along lines similar to those proposed by GAO. A gradual transition, with advancement to a higher level of competition as firms move toward competitive viability in the marketplace, is certainly much better than first totally shielding firms from competition for a large portion of their business and then abruptly terminating support entirely.

B. We do not agree with this proposal, finding it inconsistent with both the goals and the legislative history of both 95-507 and 96-481. Individual decreases in 8(a) support are certainly warranted at some point during a firm's tenure in the Program. However, mandating such decreases on a program- or industry-wide basis would serve no useful purpose consistent with the goals of the Small Business Act.

8. Before suggesting means by which the success or failure of the 8(a) Program can be measured, we would add the caveat that business development of economically and socially disadvantaged small businesses is a long term goal. It is much too early to characterize the 8(a) Program, which has only been in existence for twelve years, in contrast to the centuries-long existence of discrimination, as either a success or failure. Means by which the performance of the 8(a) Program in aiding economically and socially disadvantaged businesses can be measured should include studying what has happened to 8(a) graduates since they left the Program. By examining these firms' actual performance since leaving the Program and comparing it to their predicted performance, in terms of continued government contracts, developing commercial markets, good supplier and creditor relationships, etc., some indications as to the success or failure of the 8(a) Program can be gleaned. Similar-

ly, the firms already in the Program should be examined to determine to what extent participation in the 8(a) Program has helped them develop commercially. Examining the volume of government purchases from 8(a) graduates would be one means which could be used to measure the track record of the 8(a) Program.

We would also like to note that increasing the volume in contract dollars, the number of 8(a) contracts awarded, or the number of firms receiving 8(a) contracts is not necessarily incompatible with the business development goals of the 8(a) Program. As presently administered, maintaining the volume of 8(a) contracts may be inconsistent with developing businesses, as it has been too easy for SBA to meet the short-range goals of contract volume and ignore the long-range goals of business development. We believe that both goals are important. While SBA should not function as a "contract broker" to the exclusion of its business development role, it does have a real and valuable role in increasing the number of Federal procurement dollars which flow to small economically and socially disadvantaged businesses. No statute or regulation limits government purchases from these firms to less than 2% of all federal procurement. This already miniscule percentage must not be allowed to erode further. It need not do so.

9. If the 8(a) Program were modified into some form of a tiered system, SBA could concentrate different amounts of different types of support as needed to 8(a) firms at different levels of development. All firms do not need the same intensity or types of support at every stage. Similarly, the dollar sizes of contracts and the number of contracts necessary to attain competitive viability vary from industry to industry. SBA should better train its Business Development Specialists to recognize how much of what kind of assistance at what time a firm needs to succeed. During their tenure in the Program, firms should be expected to rely less and less upon SBA to identify contracts for them and more and more upon their own developing skills to locate, negotiate, and perform contracts. These skills are best developed within a sheltered program and will require steadily lessening amounts of supervision of a BDS.

Mr. Mitchell. I will ask our last two witnesses to come to the witness table, Mr. Aldric Hayes of H. & W. Contracting Co., and Mrs. Lillian Lincoln, president of Centennial One, Inc., Crofton, Md.

I want to thank both of you for being here with us, and we will lead off with you, Mr. Hayes, and I will save you for last Mrs. Lincoln.

TESTIMONY OF ALDRIC M. HAYES, PRESIDENT, H. & W. CONTRACTING CO., COLUMBUS, GA.

Mr. Hayes. I have been taking some notes on the questions that you have been asking and members of your panel, and after I review my statement, I would like to try to address some of these things.

I feel as a construction man, I might be able to help shed some light on those questions that have been asked.

Mr. Mitchell. Sure.

Mr. Hayes. I am Aldric M. Hayes of Columbus, Ga., and the owner of H. & W. Contracting Co. I started this company in July 1973, with two employees. Initially my contracts consisted of making home repairs, carport enclosures and room additions. These jobs were almost always very small. Contracts were difficult to obtain, and my biggest competitors were the unlicensed and uninsured, usually working under the guise of being hourly waged. I finally decided that the company could not grow or survive against these odds.

After establishing a bonding capacity of $75,000 I started bidding larger contracts. The bulk of these contracts were restoration jobs in the historic section of Columbus, Ga. The contract amount of these jobs varied between $40,000 and $75,000. The unlicensed, uninsured, and unbonded individuals were no longer my competitors. I now faced the larger companies who owned good equipment and had the necessary contacts to assist in getting contracts.

Although my company could do quality work and keep good records, I could not get sufficient jobs of the size and magnitude that the larger majority owned firms enjoyed. This inhibited my ability to maintain good personnel at reasonable rates, buy large quantities of material at a discount, or have sufficient utilization of certain equipment to merit buying. In order to become more competitive, additional jobs would have to be secured in amounts that would increase the company's cash flow.

Recognizing the fact that I needed help, I applied for procurement assistance through the Small Business Administration's 8(a) program. This business plan was approved, and I completed the first 8(a) contract on December 4, 1980. The second job, which was the preservation of the home of Booker T. Washington, Tuskegee Institute, Alabama, was completed in May 1981.

The procurement assistance provided through the 8(a) program has enabled me to improve the gross earnings, as well as our contribution to the community through more taxes being paid to local, State, and Federal governments. I have been able to more than double the number of employees. The increased amount of money paid for material benefited the business community such as suppliers, manufacturers, and other material handlers.

Some statistical data reflecting the impact that the 8(a) program has had is as follows. I have broken this down into a 12-month period prior to the 8(a) program, and a 12-month period ending March 1981.

My gross receipts before the program was $152,056 versus $740,436.

Direct material purchased before, $36,958 versus $192,733.

Paid to subcontractors, $49,462 versus $107,917.

Number of employees before, 8 average versus an average of 19.

This one is key. Total taxes paid of all kinds before, $7,000 versus $108,613 now.

In addition to tax and other contributions made through employment and purchases, a saving of approximately $44,460 may be realized from the lack of unemployment claims. As you can see, the effect of this program on H. & W. Contracting Co., the various governments and the community in general has been tremendous.

The 8(a) program is not a give away. Proposals for work are reviewed thoroughly before negotiation of final price is even started. This in my opinion insures that the Government is getting its dollars' worth, and that there are no hidden areas by the contractor or others involved in the contract.

This company has made beginners progress but has not reached a point where it can compete with larger majority owned firms. Only through proper assistance such as the 8(a) program will I be able to obtain the type assistance needed to become a viable minority-owned firm of today. I have not asked for any grants or loans from the Government. I have only asked for contracts, an opportunity to provide a service.

It is my hope that you will see fit to retain and strengthen this much needed 8(a) program.

Mr. MITCHELL. That is a startling growth pattern on page 3.

Do you attribute this startling growth to merely your 8(a) status?

Mr. HAYES. No, sir. During that period of time, I had two 8(a) jobs and 38 that I initiated on my own.

The profits and the growth that are reflected here are a combination of both what I was doing on my own and what I was able to do through the 8(a) program.

Mr. MITCHELL. Could you give us an idea of the dollar size of your two 8(a) contracts?

Mr. HAYES. I have it right here. Give me 1 second.

The two 8(a) contracts totaled $548,000 or $548,534.93. And those 38 jobs I completed on my own over a 12-month period totaled $223,320.63.

Mr. MITCHELL. So in reality, there was a combined 8(a) and non-8(a), the bulk of this growth came from the 8(a) contracts, $548,000?

Mr. HAYES. That is correct. I was able to do better on the small contracts in that the large contracts provided continuity in hiring of personnel and being able to purchase items in bulk, getting discounts on those things. So by working the two together, I was able to make a greater profit, even on those jobs that I initiated on my own than I would have had I not had the 8(a) projects.

Mr. MITCHELL. I understand completely.

Could I ask you a couple of more questions?

Mr. HAYES. I want to comment.

Mr. MITCHELL. You started your company in 1973.

Mr. HAYES. That is correct.

Mr. MITCHELL. You have been in business 8 years. Yet you make the statement you can't compete with the larger majority-owned firms. Could you be specific in telling me why you think you can't compete?

Mr. HAYES. I don't have the equipment. I can't get, rather I couldn't get projects of the size and magnitude that would permit me to buy this bulk. and do all of those things that they are doing, and when you can't do that, in essence, you can't compete, but with those jobs and more of those jobs, I feel that I will be able to compete.

Mr. MITCHELL. One last question before you continue making your statement. Congressman Evans raised a problem area which is of importance, and that is the maldistribution of the 8(a) contracts. He pointed out that in the Southern States there was not a fair proportion of 8(a) contracts in comparison to the minority business population.

If you assume that that is true, and I don't know whether you do or don't, if you assume that is true, what would be your explanation for this maldistribution?

Mr. HAYES. Well, I can only explain it as I perceive it or as I have experienced it.

One example, I have done at least 10 proposals, but I have only gotten two contracts, so I don't really blame SBA for this. You have got Federal agencies out there that don't like the program, and it appears to me that they are seeking ways to circumvent the program and its regulations.

For instance, I will do a proposal that is within the Government's estimates, and I am ready to go to work, and I have spent a lot of money doing this.

They, all of a sudden, decide that they are not going to fund it, so they drop the whole project.

Now, I have used all my help to develop this thing, and believe me, there is a lot of work that goes into it. I have to itemize all of the materials that I am going to use, every nail, the lumber, the paint, the cement, whatever. Not only do I have to itemize it, I have to shop that list, and submit at least two estimates, a minimum of two estimates on all of this material, and the same thing is applicable to the subcontractors.

If I am going to subcontract my electrical work or my HVAC, heat and air, I have to have at least two estimates on that. After I go through all of that and put it in this miniature Sears, Roebuck catalog, and then it is turned down for the lack of funds, you can imagine what this does to me. So I am saying that the Federal agency at whatever installation, are responsible for part of it.

Mr. Mitchell. Let me get squared away completely on this. Congressman Evans said that the problem was especially acute in the Southern States. Are you saying that, are you suggesting that with the Corps of Engineers or HUD or anybody else in the regional offices in the South, there is a lack of receptivity to the program, and indeed, putting it more bluntly, in an attempt to thwart the program, so the fault would not necessarily be with the Small Business Administration, but with the other agencies of Government.

Mr. Hayes. That is right.

Let me tell you another thing that they are also doing, and that is one of the things that I was going to mention.

Let's assume that they have 100 family housing units that they are going to build. These units are going to average $25,000 each, so you got $2.5 million, and they are going to permit you to build those houses over a 2-year period. I can't get bonded for a project that big, so we say how about breaking this project up. We are going to do them over a 2-year period, and let me take it one-quarter at a time.

I could get bonded for it. That is a sequence that we are going to build them and they say, no, you have got to take the whole ball of wax or none. I just don't see why that is essential, so that is one way of keeping me out. In many cases, they will give you a job that you don't have the capacity to perform, example, rehabing a nuclear reactor plant. It is on the list, you know.

If they are not cooperative, if some pressure is not placed on those people, I don't think it makes any difference what SBA does. They are going to find some way to get around it.

Mr. Mitchell. That is very enlightening, because it tends to dispel the notion that there is some monopolistic elite core of minority businessmen who get all the contracts, and this is done in consonance with SBA.

It is very, very helpful for me to hear your explanation of the problem in your particular region.

Mr. Hayes. That is what the installations can do. The other problem relates to the length of time that a contractor should remain in the program. It took me 6 years to move my bonding from $75,000 to $250,000. When I entered the program, that is about where it was, $250,000, but there were many jobs that I couldn't even take on. So the bonding caused a lot of my jobs to just go by the wayside. I didn't have the capacity to take it on, so I can't come in and do a lot of business or graduate hurriedly because the growth of bonding is slow.

So, unless some provisions are made so that we can get the capacity of bonding needed to grow fast, then it is impossible to grow fast and under the regulations as they are written, if I had the capacity to get bonding needed to grow fast, I wouldn't be accepted in the first place.

Mr. **Mitchell**. You are spelling out a clear catch-22 situation for us, and thank you.

Mr. **Hayes**. Now, don't quote me on it, because I am not sure that I am entirely accurate, but you have set-asides for small business. As I am told, the line between small business and large business is somewhere between, in construction, that is, $12 million and $13 million gross annually.

OK, if the intent is to put me in the mainstream, not a big business, but just small business, then I need to be grossing at least half of that which would be $6 million a year. So if you are going to think in terms of graduating me in the midstream of small business, that is what I should be doing, and if it is going to take me 6 years to move from $75,000 to $250,000, how am I going to get to that point?

You won't even break your projects up, so I could take them in small increments. There are all kinds of obstacles out there. You wouldn't believe, but I have experienced them. I got a hunch I am not through yet.

Mr. **Mitchell**. Well, let me thank you very much for your testimony. It is a part of the record. You said you might not be completely accurate, but the essence of what you are saying is significant enough that I certainly would want it to be a part of the record.

Mr. **Hayes**. What I am saying is accurate, except for the cutoff between small business and large business. I don't know for a fact that it is $12 million or $13 million, but it is somewhere in that area, and all I am saying is if you want to put me in the mainstream of small business, then let me at least do $6 million annually, and if you want me to compete with big business, then I need to be doing about $15 million or more. And I would be at the bottom of them.

I would agree with those who say that I shouldn't be permitted to come into the program and remain forever, but then give me some kind of mechanism so that I won't have to be in there forever. Break up the projects that can be broken up, so that I can take them. Assist me in getting the bonding that I need, and if you do those things, and then I fail, well, kick me out. I had my chance. I have had my day.

Mr. **Mitchell**. You have been a very excellent witness, and I am sorry the other members are not here, and I will encourage them to read the entire record of this hearing. You put things on a very simplistic basis without a lot of rhetoric. You want me to move to this point, and you place on me the impediments, and the impediments are constantly shifting.

Thank you, sir.

Mrs. Lincoln, I held you for last. I understand you were honored by my State as being one of the most successful minority business persons with the CETA.

TESTIMONY OF LILLIAN H. LINCOLN, PRESIDENT, CENTENNIAL ONE, INC., CROFTON, MD.

Mrs. LINCOLN. That is correct.

Mr. MITCHELL. I wanted to add my congratulations to the honors that have already been heaped on you.

Mrs. LINCOLN. Mr. Chairman, I appear before you today to testify in opposition to legislation which has been introduced to terminate the SBA 8(a) program. The termination of this program would be disasterous for all businesses that participate in the program—those who have relied totally on the program for their existence as well as those who have developed plans for extending their contracting capability beyond the 8(a) program. It would, therefore, have a devastating effect on the overall growth of minority businesses in this country.

In this age when the President is emphasizing economic austerity and proposing budget cuts to streamline Government spending, it seems that programs which keep people employed would contribute to the President's economic goals. While it is true that some of the employees employed by 8(a) contractors would not be affected by the elimination of the 8(a) program, many of them would be.

All owners and management personnel would probably be unemployed. The contracts they presently perform on would be contracted to another company now in existence—probably a majority firm—who may retain some of the employees presently working for the 8(a) firm. But in all probability many of the employees, particularly management personnel, would be replaced.

As I see the 8(a) program, it is not, nor was it intended to be, a handout program. Once an 8(a) contractor is awarded a contract, it is required to perform just as any other contractor is required to perform; 8(a) contractors are not asking that they be allowed to provide less than the required quality of products or services, but that they be given the chance to develop the skill and talent required to perform adequately.

It seems to me that a more practical approach for dealing with the current status of the 8(a) program would be to define the problems which exist and then develop policies and procedures to deal with those problems. To terminate the entire program is like throwing the baby out with the bath water.

There has been an inordinate amount of press about the 8(a) program—all negative. I find it hard to believe that the program has been a total failure; that all 8(a) contractors are out to rip off the Government, or that all 8(a) contractors are front operations for majority contractors. There are some successes in the program.

In my opinion, the reason that failures of the program have been disproportionately highlighted is because critics have made it a point to look for the failures. If the same energies were directed toward looking for the successes, I would venture to guess that the successes would outnumber the failures. But, it appears that success stories don't make news; failures do.

I consider Centennial One, Inc., a success largely because of the 8(a) program. The company was organized in 1976 for the purpose of providing janitorial services to both Government and commercial buildings. Immediately after the company was begun, I explored the possibility of securing contracts in the commercial market and the Government competitive-bid market. On commercial jobs, I was never given the chance to bid on any available work. Usually it was requested that I provide a list of other commercial work on which the company had performed.

On competitive-bid work, I filled out a number of form 129's—bidder's application—but could not meet the minimum experience requirement in the RFP's. I then decided that the only possibility of entry into this market was through the 8(a) program. The company was approved for the program in July 1976 and the first contract was awarded October 1, 1976, in the amount of $152,640 requiring 20 part-time workers.

After the award of this contract, the conscientious decision was made to postpone any further marketing for at least 6 months in order to direct the company's resources toward performing on the contract which has been awarded to us and be able to iron out any problems that could benefit the company on future contracts. In the very beginning, I defined the company's philosophy as providing quality service at competitive prices.

Since participating in the program, Centennial One has benefited in the following ways:

One, increased our ability to become more competitive on our bids on non-8(a) work. Centennial One, Inc., has been bidding on competitive Government work for the last 3 years. We won our first competitive bid job in March 1981. Bidding low requires little or no skill. But bidding low and performing within that bid requires good management and the utilization of economics of scale which are frequently not available for the small business. While an established firm may be able to absorb the loss from a low bid, the new firm could fail as a result of an underbid.

Two, developed a staff of personnel trained in management in the janitorial industry. The building services industry is no longer a mop and pail industry, and yet there are no schools teaching the kinds of skills needed to insure a ready market of human resources.

Therefore, the SBA's 8(a) program has allowed Centennial One, Inc., the opportunity to develop, to a great degree, a technical staff sufficiently trained in management skills in the industry. This increases the company's ability to remain competitive.

Three, secured a line of credit from the bank through the use of receivables from 8(a) contracts as collateral. Any business needs a good banking relation. Without it a company's growth potential is limited and its ability to maintain current operations may be hampered.

Four, secured direct bonding capability which eliminates the need to rely on the SBA bond guarantee program. Bond capacity is absolutely necessary in order to compete in bids for Federal and State Government work. Most firms cannot bid on Government jobs during its infancy because many do not qualify for even the SBA bond guarantee program.

Now that Centennial One, Inc., has developed a good banking relationship and direct bonding capacity, it is imperative to maintain a consistent or increasing level of sales to assure that these resources remain available. For the last year all of our marketing efforts have been directed toward securing non-8(a) work. My last new 8(a) contract was awarded as of October 1, 1978. I started my first non-8(a) contract on August 1, 1977, in the amount of $14,400.

By December 31, 1978, non-8(a) work represented about 4 percent of my total business. This has gradually increased over the years to 14 percent as of May 31, 1981—3.8 percent competitive Government, 5.1 percent State and local government and 5.1 commercial. To terminate the program now would eliminate my bonding capacity and my established line of credit because of a drastic reduction in sales. While I feel I am well on the way to developing a sound base for existing without the program, I am not there yet.

Based on the sales data which I have just submitted, Centennial One, Inc., could survive only, but it would be very difficult, if not impossible, to grow or maintain the present level of performance.

Centennial One, Inc. has been in the 8(a) program for about 4 years and 9 months. If the program is terminated at this time, there is no question that the company would be greatly affected. As indicated by the percentages previously quoted, the amount of non-8(a) work has increased each year, but at a slower than desired rate. The reasons for this, as I see it, are as follows:

One, the commercial market is extremely difficult to penetrate. Private building owners have no requirement to contract with any particular type of contractor. The contractor who is already performing on a contract may have been there for years because there is no requirement to rebid the job each year.

In addition, many contracting decisions in the private sector are made in nonbusiness environments—that is, golf courses, country clubs. Minority persons are still not privy to these social facilities in any meaningful numbers.

Two, in the janitorial industry, Government contracts are usually much larger than commercial or State and local government contracts. Therefore, one 8(a) contract may be the equivalent of multiple non-8(a) contracts which generally are much smaller in size.

Three, many management companies will require that a prospective contractor have experience on commercial contracts of equivalent size before allowing the opportunity to bid on a prospective job. So a contractor finds himself in a catch-22 situation. It is impossible to get the required experience until someone awards you a contract on which to acquire experience.

Four, even today, 1981, racism still plays a role in the ability of minority businesses to secure contracts. While in my particular case discrimination has not been a major factor, there are incidents which I can cite whereby individuals refused to do business with me because of my race and/or sex.

Since its inception, Centennial One, Inc., has grown from 20 part-time employees to a total as of May 31, 1981, of 270—234 full-time and 36 part-time employees. The company emphasizes employment of the unemployed or underemployed. We hire the handicapped, veterans, recipients of Government assistance, ex-convicts, and others that many companies refuse to hire.

Centennial One, Inc., also makes contributions to the overall economy through payment of its taxes.

[Information referred to above follows:]

	1979	1980
Federal Tax Liability	$70,393.00	$58,628.00
State Taxes:		
Maryland	$4,192.00	$6,198.00
Virginia	1,197.00	1,614.00
District of Columbia	442.00	566.00
	$5,331.00	$8,478.00
Federal Unemployment	$ 9,065.00	$ 4,626.00
	$32,795.00	$56,764.00

In addition, we paid withholding taxes for our employees in the following amounts:

	1979	1980
Federal Government	$145,399.37	$194,444.41
District of Columbia	10,962.64	17,451.87
Maryland	36,873.32	52,339.91
Virginia	8,810.61	10,071.68

Because of the type of people we employ, we were eligible for job credits in 1979 in the amount of $100,000 and in 1980 in the amount of $53,304.

The existence of Centennial One, Inc. impacts on other companies through our purchase of goods and services. For fiscal 1979 and 1980, the following purchases were made from majority-and minority-owned businesses:

1979	Supplies & Equipment	Services
Majority Firms	$128,392.00 (99.0%)	$88,302.00 (88.5%)
Minority Firms	1,297.00 (1.0%)	11,475.00 (11.5%)
	$129,689.00 (100%)	$99,777.00 (100%)
1980	Supplies & Equipment	Services
Majority Firms	$133,130.00 (87.2%)	$121,278.00 (86.6%)
Minority Firms	19,527.00 (12.8%)	18,698.00 (13.4%)
	$152,657.00 (100%)	$139,976.00 (100%)

Mrs. LINCOLN. Mr. Chairman, I would like to conclude my testimony by saying that minority businesses should not be expected to develop and mature faster than other businesses. Studies have been made to show that the first 3 years of a business's existence is a period of high risk and many are in danger of failure during the first 5 years.

In my business, expansion into the private sector is not, for the minority business, as easy as some would have you believe and being the low bidder when competing with established firms on competitive Federal contracts is frequently just as hard.

To enter either of these markets requires the development of an expertise that the minority business just cannot develop in a short period of time. Therefore, the 8(a) program is vital; and I urge this committee to vote against the proposed legislation and retain the 8(a) program.

I thank you for this opportunity to testify before the committee.

Mr. MITCHELL. Thank you very much and thank you for your patience in waiting through this long hearing.

You started your company in 1976?

Mrs. LINCOLN. That is correct.

Mr. MITCHELL. Fourteen percent of your business is other than 8(a)?

Mrs. LINCOLN. Correct.

Mr. MITCHELL. That took about 5 years for you to get to that point where you had 14 percent other than 8(a)?

Mrs. LINCOLN. The first 6 months I didn't really do much marketing in the competitive bid market.

Mr. MITCHELL. Given that growth pattern, in your opinion at what point do you think you should leave the 8(a) program?

Mrs. LINCOLN. Given, if things continue at that rate——

Mr. MITCHELL. Which you have gotten other than 8(a) business.

Mrs. LINCOLN. I would say it would take another 10 years before I would even be competitive enough going at that rate.

Now, things could get better or worse.

Mr. MITCHELL. If that rate is maintained you would consider another 10 years?

Mrs. LINCOLN. At least.

Mr. MITCHELL. Before you would feel comfortable in going out into full competition.

May I ask you a question with reference to those who would want to graduate firms based upon a dollar volume of business. How do your profits annually compare with an average of profits in this whole janitorial field for nonminority firms?

Mrs. LINCOLN. OK, I am not at the lower end, not at the bottom. I am not at the top. I am profitable but I don't think, one of the committee members mentioned profit as a guide. I don't think you can isolate any one particular criteria to determine whether the company is successful, and neither do I think you can use a set rate of a number of years, because within different industries and among companies within the industry.

Mr. MITCHELL. You answered my last question that was coming up, whether or not you thought just the amount of profit was a reasonable and safe way of deciding graduating criteria.

Mrs. **Lincoln**. No; I don't, and even if you are using profit, you have to show a history of profitability. I am profitable now, but if you took all my 8(a) contracts away, I wouldn't be profitable.

Mr. **Mitchell**. Thank you very much, and I appreciate the testimony from both of you, and I thank all of you who have participated in this rather long hearing. We have made out a pretty clear case so far that minority firms are simply not going to make it without an 8(a) program.

In addition to that, I think we have raised some very serious questions about the length of time that it takes to graduate a firm and the criteria upon which this graduation should be determined. We will have one more set of hearings on June 10, and by that time I hope that we will take action after we have had the last set of hearings, and I think we will be able to take action on the piece of legislation that in part prompted these hearings.

Thank you very much for your attendance and for your patience throughout a very, very long hearing.

The hearing now stands adjourned.

[Whereupon, at 2:10 p.m. the subcommittee adjourned, to reconvene subject to call of the Chair.]

SMALL BUSINESS ADMINISTRATION'S 8(a) PROGRAM

WEDNESDAY, JUNE 10, 1981

House of Representatives, Subcommittee on SBA and SBIC Authority, Minority Enterprise and General Small Business Problems, Committee on Small Business,

Washington, D.C.

The subcommittee met, pursuant to notice, at 8:30 a.m., in room 2359-A, Rayburn House Office Building, Hon. Parren J. Mitchell (chairman of the subcommittee) presiding.

OPENING STATEMENT OF CHAIRMAN MITCHELL

Mr. Mitchell. The hearing will come to order.

Today is the third of three hearings on the Small Business Administration's 8(a) program. This program is designed to facilitate the development and expansion of socially and economically disadvantaged businesses into the economic mainstream of this country.

SBA is required by law to try to reach this objective by providing procurement, management, and technical assistance to 8(a) and non-8(a) socially and economically disadvantaged firms.

At the first hearing on May 21, 1981, SBA Administrator Cardenas reasserted to this subcommittee the Administration's strong support for continuation of the 8(a) program.

In the second hearing on June 4, 1981, Congressman Billy Evans, 8(a) contractors, minority trade association representatives, and a Washington attorney specializing in the legal theory supporting minority economic development offered varying views on the effectiveness of the 8(a) program as it exists today.

Though differing in some aspects of their testimony, all of the witnesses reinforced their opinions that without a special program to assist minority entrepreneurs in reaching viability, a free enterprise system which is neither color- nor class-blind would defeat their efforts, and in so doing deny America the benefit of one of its most underutilized resources.

The argument persists as to whether the Federal Government has an obligation to assist minority business. Why can't these entrepreneurs make it on their own? This Nation's highest legislative body addressed that question in 1978 by passing legislation mandating a strong minority economic development program.

It reasoned that only the Federal sector had the strength and resources to combat the social and economic racism facing minority Americans as they sought to participate fully in the laissez-faire system which built this country.

Equality in America has as its underpinning economics. Minority economic development is a concept, now embodied in law, which seeks to bestow equality of economic status to one group of Americans for whom it has also been necessary to mandate equality in other noneconomic areas.

To date, Federal efforts have been concentrated primarily in the SBA's 8(a) procurement program. Yet a comparison of minority entrepreneurs to majority entrepreneurs in sales, labor, and capital intensiveness, participation by the banking, venture capital, and private investment sectors, and any of the other factors and indicators which measure business and industrial growth demonstrates the paucity of impact which this program has caused.

However, it remains the cornerstone of the Federal effort and must be expanded and strengthened less America shirk her responsibility to those Americans born involuntarily into a group still suffering from social and economic discrimination.

The subcommittee has heard exhaustive testimony regarding alleged fraud, waste, and mismanagement in contradiction of the equally exhaustive and ardent support for the program's goals and objectives.

We must, at today's conclusion, begin analyzing this testimony so as to direct the Small Business Administration in its necessary efforts to strengthen the 8(a) program and eliminate the possibility of further program deterioration.

We must also guide SBA as it appears to have implemented a course of action—under that effort—which is administratively and legally troublesome.

Today this subcommittee will finish this phase of inquiry into the SBA 8(a) program. This hearing will focus on economic theories of minority and small business growth and capital needs.

Additionally, we will examine Federal procurement procedures which are in effect or contemplated and initiate an analysis of their consistency with economic theory and Federal law.

I am pleased to hear from Federal procurement officers, one of the largest trade associations representing small business, and financial and economic experts in the area of small and minority business.

Our first witness is James Walter, a professor of finance, Wharton School of Finance, University of Pennsylvania.

We have a copy of your prepared statement. We will ask you to proceed.

TESTIMONY OF JAMES WALTER, WHARTON SCHOOL OF FINANCE, UNIVERSITY OF PENNSYLVANIA

Mr. **Walter**. Do you want me to read it?

Mr. **Mitchell**. You can either read it in its entirety, or you can submit it for the record and just speak to the highlights.

Mr. **Walter**. Let me do something in between.

It is short.

Mr. **Mitchell**. I would suggest that you pull your mike a little closer to you.

Mr. **Walter**. This statement is directed at the effect of Federal taxation on the motivation to start a new small business and the availability of financing for small businesses.

I really don't think there is any need, although I have discussed it in my prepared statement, to debate the importance of small business.

I think it is clear that in terms of the numbers of tax returns, in terms of the contribution to employment, and in view of the fact that small business has increased its share of the total employment in this economy, that in a sense all big businesses originally started as small businesses, we can accept the notion that a nation of small businesses is a healthy nation.

So, I really don't think there is need to carry that discussion further.

What we are concerned with, however, is that the Federal tax system be equitable. A colleague and I a year ago completed a monograph for the Heller Foundation entitled "Tax Incentives for Small Business."

We started with the conviction that the corporate income tax fails to make due allowance for intersize differences in the ability of corporations to generate cash internally, and to gain reasonable access to the capital markets.

The large diversified corporation offsets the net operating losses of unprofitable divisions against the before-tax income of other divisions.

The large company also finances the growth of some divisions internally from the cash flow of other divisions without the funds transferred being subject to the double taxation that is inherent when corporations declare dividends, distribute them, and they are reinvested, but before they are reinvested they are subject to our personal income tax.

So our proposed package of tax changes is really aimed at reducing the differential treatment that currently exists between large and small business. We feel that the tax changes that we have in mind divide conveniently between those modifications that are primarily applicable to small business still in its loss phase—that is, its initial development stage—and those most relevant to emerging profit firms.

Equitable tax treatment for small firms still in the loss phase requires that the losses be passed through to or applied against other taxable income in timely fashion. There really is no sense in increasing the allowable expenses for a business that is not making profit—it simply has no otherwise-taxable income against which these expenses are offset.

We also feel that equitable and supportive treatment of emerging profit firms that remain unable to develop or tap the public market necessitates the adoption of provisions for rolling over capital gains and dividends and procedures designed to facilitate internal cash generations.

Our specific recommendations for firms in the loss phase of their development include, first of all, the extension of the subchapter S concept. In particular, we feel that broadening the at-risk limitation makes a great deal of sense. There are a number of other changes, but many of these changes have already been proposed in legislation of one kind or another.

Second, we would recommend that provision for loss reserves be made at the outset of the equity financing. In other words, where there is an expected loss involved, it seems appropriate to allow a reserve at the outset.

I prefer the reserve notion to a tax credit, incidentally.

Third, we would like to see greater leeway granted suppliers in establishing their bad debt reserves for credit sales to loss ventures.

Finally, as far as the loss phase is concerned, we would recommend that the interest deduction for tax purposes be transferred to the lender at the borrower's election. We believe this is quite important when we start to think about the asymmetrical character of the interest tax deduction.

In other words, interest cost to the borrower, if the borrower is profitable, is usually thought to be the interest charge times one minus the tax rate. Whereas to a firm that is unprofitable, the interest cost is obviously the total interest charge.

In these days of high interest rates, this makes a rather significant difference. If the borrower was allowed to transfer the interest deduction to the lender, then this would in effect make a reduction in his after-tax cost comparable to the large firm that is profitable.

Now let's look at suggested modifications in the tax treatment of emerging profit firms. These are firms that have managed to survive the loss phase and are now in shape to move ahead but still don't have access to capital markets in at least any reasonable fashion.

In this area, what we would propose is that taxes be deferred both on capital gains and on the dividends attributable to small business, provided that these funds are reinvested in small business.

The reason for the deferral of dividends is basically that if the firm has little access to the capital markets, it is unlikely that equity interest in the firm can be sold at any reasonable relation to the firm's value.

So, the principal way that you can hope for an early return on your investment is through the declaration and payment of dividends.

I am not speaking of the owner-manager person who gets his return in salary but an outside, noncontrol investor who is not in a position to sell stock at a fair price, really can only get his return through dividends, and consequently we feel that the idea of deferring taxes on dividends, allowing him to reinvest in other small businesses, makes a great deal of sense.

Second, we subscribe clearly to the idea of simplified and expedited depreciation, the simpler the better, for small firms. We would, although we don't think that it has the power that some people believe, argue for the extended carryforward of operating losses; in other words, the point simply being that if there has been an extended loss phase under present conditions, an operating loss carryforward provision may run out before profits are obtainable.

We don't think this is as important as some of the other ideas for the simple reason of the time value of money. If you have to wait 10 years to get your tax deduction, in present value terms, this doesn't make much difference, but it is better than nothing.

As far as impact on small business is concerned, you can, of course, list a great many items as the ingredients for success in starting and continuing a new business. They include the profit-making idea, or flow of ideas, the management and technical know-how, the motivation, the capital, and the discipline not to overextend yourself as the firm is developing.

Obviously the state of the economy and on occasion pure luck are also highly relevant considerations.

Our proposals for modifying the tax system strike directly, we think, at the motivation to start and to operate a small business, and also at the availability of capital to small enterprise.

We feel that motivation hinges on the prospective rewards relative to the risk assumed. We feel that all too often talented members in particular of minority groups have been encouraged to go with big Government and big business as opposed to small business by the favorable reward risk ratio. We would like to see this redressed.

The availability of capital to small business likewise depends upon the anticipation of an acceptable return in relation to the risk assumed. Suppliers of noncontrol credit funds whose primary interest is in selling goods and services to small businesses extend credit primarily to achieve the sale. Their concern is with the profit margin, the receivables turnover, the cost of their capital, and bad-debt expense.

Obviously in this case it is profits that motivate. But the issue of the bad debt expense does come up in a relevant fashion.

So far as suppliers of credit whose primary concern is to lend, their motivation obviously is interest income net of bad debt expense. We feel in this case that the potential benefit resulting from the transfer of the interest deduction where the borrower elects to do so makes a lot of sense in motivating additions to this source of supply.

Obviously the suppliers of noncontrol equity financing are clearly motivated by two kinds of things. One is the prospect for an ultimate very large return in relation to the risk they are assuming. They are also, of course, motivated by the net investment at stake taking into account their ability to write off expected losses early in the game.

The concept of present value indicates that deferrals when the required rate of return is high, as might be indicative where there is a considerable amount of risk, cause writeoffs to lose their significance rather rapidly in a value now sense.

To summarize our proposals designed to improve the equity of the Federal tax system as it pertains to small business do indeed provide powerful incentives for small business. We think they provide powerful incentives without going into the rather hairy area of outright tax subsidization.

We think these are legitimate modifications in the tax structure, in the light of the comparable treatment. Our intent in making these proposals is basically to render the tax system at least neutral in its effect on the allocation of resources.

We think the critical test really should be whether or not an innovative person has the same opportunity for developing a creative idea on his own as he would as a member of a large corporation.

[Mr. Walter's prepared statement follows:]

PREPARED STATEMENT OF JAMES E. WALTER, PROFESSOR OF FINANCE, WHARTON SCHOOL, UNIVERSITY OF PENNSYLVANIA

This statement is directed at the effect of federal taxation upon the motivation to start a new (small) business and the availability of financing for small businesses. In the treatment that follows, brief consideration is given to (1) the importance of small business to the U.S. economy, (2) proposed modifications in the tax system designed to minimize the differential tax treatment between large and small enterprise, and (3) the incentives afforded by such proposals for small business.

1. IMPORTANCE OF SMALL ENTERPRISE

Small business is important to the American economy on several grounds. Smaller firms have been a key factor in job creation. Companies with less than 100 employees accounted for nearly 55% of total employment in 1977, up from 49% in 1967.

While difficult to measure precisely, the contribution of small business to technological change appears to be much greater than in proportion to its size in the economy. This is particularly true with respect to technological innovation, that is, making technologically feasible an idea for a product or a process. Commercial development is, however, often left to larger firms due to constraints on management and capital available to the small enterprise.

Small business contributes significantly to the achievement of other economic goals including the development of an adequate housing stock and the maintenance of our urban centers. The relative importance of small firms in the construction industry suggests that policies designed to benefit small business benefit housing to a degree. The same might be said for small businesses located in urban centers.

In addition, small business is often judged important on social and political grounds. A nation of small businessmen is consistent with, and supportive of, the Jeffersonian concept of democracy which depends upon an independent and self-sufficient electorate.

2. PROPOSALS FOR CHANGE

In our Heller Foundation paper, entitled "Tax Incentives For Small Business," my colleague and I concluded that the tax system—as presently constituted—discriminates against small enterprise. In particular, we believe that the corporate income tax fails to make due allowance for intersize differences in the ability of corporations to generate cash internally and to gain reasonable access to the capital markets. The large, diversified corporation offsets the net operating losses of unprofitable divisions against the before-tax of other divisions. The large company also finances the growth of some divisions internally from the cash flow of other divisions without the funds transferred being subject to double taxation.

Our proposal package of tax changes, aimed at reducing the differential treatment that currently exists, divides conveniently into those modifications primarily applicable to small business still in its loss phase and those most relevant to emerging profit firms. Equitable tax treatment for small firms still in the loss phase requires that losses be passed through to or applied against, otherwise taxable income in timely fashion. Equitable and supportive treatment for emerging profit firms that remain unable to tap the public market necessitates the adoption of (a) provisions for rolling over capital gains and dividends and (b) procedures designed to facilitate internal cash generations.

Our specific recommendations for firms in the loss phase include:

(1) The extension of the subchapter S concept, e.g., by broadening the at-risk limitation;

(2) The provision for loss reserves at the outset of the equity financing;

(3) Greater leeway for suppliers in establishing bad debt reserves for sales to loss ventures; and

(4) Transfer of the interest deduction for tax purposes to the lender at the borrower's election.

Suggested modifications in the tax treatment of emerging profit firms include:

(1) The deferral of taxes on both capital gains and dividends attributable to small business, provided the funds are reinvested in small businesses;

(2) The provision for simplified and expedited depreciation; and

(3) The extended carry-forward of operating losses.

3. IMPACT ON SMALL BUSINESS

The ingredients for success in starting and continuing new business comprise (1) the profit-making idea (or flow of ideas), (2) the management and technical know-how, (3) the motivation, (4) the capital, and (5) discipline. The economic environment and, upon occasion, pure luck also play strategic roles.

Our proposals for modifying the federal tax system, summarized above, strike directly at (a) the motivation to operate a small business and (b) the availability of capital to small enterprise. Motivation hinges upon the prospective rewards relative to the risk assumed. All too often, it appears, talented members of minority groups have been encouraged to go with big government and big business, as opposed to small business, by the favorable reward-risk ratio.

The availability of capital to small business likewise depends upon the anticipation of an acceptable return in relation to the risk assumed. Suppliers of nonequity funds whose primary interest is selling goods or services to small business extend credit principally to achieve the sale. Their concern is with the profit margin, the receivables turnover, the cost of their capital and bad debt expense. Suppliers of nonequity funds whose prime function is lending have only interest income, net of bad debt expense, as the incentive for lending. Suppliers of noncontrol equity funds presumably have much the same viewpoint as the owner-manager

a. Tax incentives and motivation

Anything that either expedites or increases the net returns to owner-operators after allowing for external capital costs, taxes, and incremental risk presumably adds to their motivation. To the degree that they moderate risk to the external equity investor and thereby reduce the cost of equity capital, therefore, extension of the Subchapter S concept and provision for equity loss reserves operate indirectly as incentives. To the extent that owner-operators invest their own capital, the foregoing serve directly as incentives.

It is well known that the treatment of interest as deduction for tax purposes gives rise to asymmetry. The cost to profitable firms is commonly taken to be the interest rate charged times one minus the tax rate. The corresponding cost to firms still in the loss phase is the interest rate itself less the present value—if any—of the carry-foreward privilege. Given a combined federal and state tax on profits that approaches 50 percent, the interest cost differential to profitable and unprofitable companies can be substantial. Our proposal to transfer the interest deduction to the lender at the borrower's discretion redresses this inequitable treatment in part and adds directly to the owner-operator's incentive to be in business.

Deferral of taxes on capital gains and dividends, conditional upon reinvestment in risky enterprise, affords the owner-manager greater potential rewards and greater flexibility. Scaling down the tax rate, based upon duration of holding and rate of inflation is also warranted to adjust for the difference between real and nominal gains.

b. Supply of capital

Given the time value of money, the sooner a deduction is allowed for tax purposes the greater is its impact upon the supply of capital. Our proposal to extend the Subchapter S concept is consistent with the notion of passing anticipated investment losses through to taxable income as quickly as possible. Our recommendations for debt and equity loss reserves are also aimed at equating the net investment at stake with its likely realization.

To lenders, the transfer of the interest deduction can act as a powerful incentive to provide more funds to loss-phase companies. To risk-taking equity investors, the tax treatment of capital gains and dividends is important.

4. CONCLUSION

In short, our proposals, designed to improve the equity of the federal tax system as it pertains to small business, provide powerful incentives for small business. The intent is to render the tax system neutral in its effect upon the allocation of resources. The critical test is whether or not an innovative person has the same opportunity for developing a creative idea on his own as he would as a member of a large organization.

Mr. **Mitchell**. Thank you very much for your testimony.

You mentioned one or two recommendations. Where business has little or no taxable income, how do your proposals really aid that business in terms of either acquisition or retention. One or two of them jump out at me.

Would you elaborate on that?

Mr. **Walter**. Where the business itself we assume initially generates little or no income, obviously to survive it has to get its funds from outside sources, sources outside of the firm, which means that in some sense of the word the suppliers of such capital have to be motivated to do so.

Where there is a substantial amount of risk involved, and there is no prospective return in sight at all, you cannot really expect anyone to put up money. But where there is a potential for a substantial return, if the company can hold on, then in essence the question is can we motivate sufficient additional equity capital to give the small business that opportunity.

What we have in mind in this instance, then, is to look at it from two ends. One is what is the investment initially at stake. To minimize that, we think in terms of allowing the providers of equity funds not an initial tax credit for making funds available, but rather to set up a loss reserve, much the same as a supplier of goods in connection with bad debt expense; and we allow them to do it initially.

We would also argue that they should be able, much like the subchapter S concept, to writeoff losses against their otherwise taxable income as the company sustains losses in those initial phases; from an asset standpoint at any rate, investment value is reduced as losses occur.

When the limit of the loss reserve is reached, further writeoffs of losses would be permitted up to the limit of the equity investors total at risk investment in small business.

The present limitation of the subchapter S concept is the at risk investment in a particular small business, not in the totality of such investments. We feel that since a large corporation really has this opportunity of diversifying, of in effect matching profits from some of his small businesses against losses of other, we think that a venture capital pool, whether it is in the form of a partnership or a corporation, really ought to have the same opportunity, up to its total at risk investment.

So that is in a sense a front-end recognition of prospective losses, which is from a present value standpoint, it seems to me, clearly the most important consideration, particularly since we are talking about rather high rates of return in relation to risks and in relation to the present state of the economy.

At the other end, what we feel is that obviously an equity investor in a new business is interested in that small probability of fairly high return sometime in the future, and if we tax those returns excessively—we are talking about capital gains and perhaps some return through dividends, if we tax those returns excessively—obviously we fail to motivate the investor.

It is true that the capital gains tax rate has been reduced, but we still remember that under conditions of inflation, the capital gains tax presumably applies to a capital gain that is part real and part monetary, so that in effect its burden is appreciably greater if you have to wait for a considerable period of time than we normally would think.

We put in the notion that basically the capital gains taxes and also those on dividends from the small business would be deferred as long as the funds were reinvested in small business.

We thought that this provides—it also makes it more comparable with the large firm—but in addition it provides the incentive for people to keep their gains in this area.

Mr. **Mitchell**. Thank you for your response.

One of the problems we are wrestling with on this subcommittee and the full committee is a problem directly related to minority business, but I think it is equal and applicable to all businesses.

The problem is that Mr. Cardenas, the Administrator of the Small Business Administration, has proposed that minority businesses which have an 8(a) status ought to be graduated from that program in 3 to 5 years, the assumption being that they are strong enough to compete in the free enterprise system.

I think the feeling of the members of the subcommittee is that that is too short a period of time. On the other hand, you have some studies which were done at the request of SBA, suggesting that before a business really becomes viable, capable of full competition in the system, that it might take as much as 20 years.

I have two questions to you. How applicable are these proposals to the growth cycle of a business, as recognized by other experts—let's say the 3- to 5-year period? Would your proposals be as applicable there as they would be to a 15- to 20-year period?

Mr. **Walter**. Our proposals actually split the difference. What we said is the firm could remain in the loss phase for these purposes for a period of roughhy 10 years. The same kind of duration might apply to the emerging profit status. What we feel is that——

Mr. **Mitchell**. So you come down with really almost a 20-year period, too, don't you?

Mr. **Walter**. Yes, but I think the real issue is whether the small business is making progress. Consequently, I would heartily subscribe to a review in the 3 to 5 years, a rather serious review of whether or not the small business is generating a flow of product ideas and so on which will in effect at some point give it a chance to reduce its dependence on the 8(a).

Mr. **Mitchell**. I certainly would subscribe to that. I would think that in the 5- to 7-year period a company may still be showing losses, but they are diminishing losses, which would be a healthy sign.

Mr. **Walter**. There should be evidence, it seems to me.

Mr. **Mitchell**. Thank you very much. I want to make sure I am straight. Your maximum period would be a loss phase of 10 years, give or take a couple of years, and the emerging phase, another 10 years.

Mr. **Walter**. Those are the maximum. In essence, you need to allow time. There is absolutely no question about it. The real problem in all of these is to differentiate between the firm that is going nowhere and the firm that has something to offer to the economy.

Mr. **Mitchell**. Thank you.

Mr. Daub?

Mr. **Daub**. Thank you, Mr. Chairman.

The transfer of the interest from the borrower to the lender in a loss circumstance, does that give the lender any other advantage?

Mr. **Walter**. No, it purely and simply gives the lender the right to in effect exclude that interest income, assuming he gets it, from taxable income.

Mr. **Daub**. Would you allow the same kind of a transfer of interest loss to the lender if it was in fact a Government guaranteed loan to begin with?

Mr. **Walter**. Well, the guarantee portion, yes. Obviously if it were a tax-free loan, there would be no question about it.

Mr. **Daub**. To the extent that the lender might be even more willing to loan money to a business less viable than normal, since he knows for two reasons, No. 1 it is guaranteed and No. 2 he can also get the interest back and improve his bottom line profit margin and turn his money over.

Mr. **Walter**. The key issue here is what is the real cost to the borrower. If the borrower is making money, obviously the cost after taxes is the interest cost multiplied by 1 minus the tax rate.

Now, the interest cost itself is going to be a function of the risk. If the loan is guaranteed, obviously the lender—not obviously, but we hope the lender would give it a preferred status. That means offer it at the minimum loan rate that is available.

But that still does not take away from the fact that interest is deductible for tax purposes to the borrower if the borrower has income against which to offset.

Mr. **Daub**. Where there is a loss and the potential risk for the lender requires it?

Mr. **Walter**. There are really two separate considerations, it seems to me.

Mr. **Daub**. Would you see the lender negotiating for that interest reclaimed in terms of giving the borrower who is in a loss position a better deal?

Mr. **Walter**. Oh, that is the idea, to make funds available.

Mr. **Daub**. With respect to small business, and then more specifically section 8(a) as it applies to socially disadvantaged business opportunity, have you examined the concept, for example, of the Kemp-Garcia bill as it is now reconstructed, the enterprise zone concept, for its impact on tax relief to small businesses?

Mr. **Walter**. Not really.

Mr. **Daub**. Thank you very much. Appreciate your testimony this morning.

Mr. **Mitchell**. I am very pleased to announce Congressman Addabbo and Congressman Crockett have joined us at this hearing.

Do you have any questions at this time?

Mr. **Crockett**. No questions.

Mr. **Mitchell**. Congressman Addabbo?

Mr. **Addabbo**. Thank you very much, Mr. Chairman.

I want to commend Dr. Walter on his statement, especially his first opening statement, on the importance of small enterprise. Too often this is the language we hear, and we hear it even in this administration, we hear about the importance of small business and how it is 80 percent of the economy.

But then when you look to what is being done for small business, you find it in the reverse as far as benefits. You feel that in view of the fact that our economy and our business world is so dependent on small business, that in some cases, as you put it in your last sentence, or your last sentence in part 1, where you say a nation of small businessmen is consistent with and supportive of the Jeffersonian concept of democracy which depends on independent and self-sufficient electorate, that sometimes the Government has to give a little extra aid to a segment of the economy—in this case small business—so that they can become independent and part of the mainstream.

Mr. **Walter**. Let me simply put it this way. I think we tend to be responsive to the extent we have a stake in society, and obviously small business as opposed to large business implies a more direct stake in the economy, as we know.

Mr. **Addabbo**. Therefore, in some instances they are entitled to some extra help by the Government, whether it be a subsidy of interest or et cetera.

Mr. **Walter**. I would agree. In my statement what I felt was that why don't we start with the question of equity between large and small business from the tax standpoint, see how those incentives work, and go from there.

Mr. **Addabbo**. Thank you, Mr. Chairman.

Mr. **Mitchell**. Thank you. Thank you very much. You have expressed some very cogent proposals.

Mr. **Walter**. By the way, there are some errors in this statement. I apologize. I will correct them.

Mr. **Mitchell**. Thank you.

Our next witness is Mr. Daniel C. Montano, the president of Montano Securities Corp., Los Angeles, Calif.

We are delighted you took this long journey for us. I am particularly interested in your testimony because you will be talking about access to the capital markets. We have a subcommittee that has been working on that for a number of years.

The problem still is not solved. In my opinion, one of the greatest impediments to the growth of minority businesses is the lack of access to the capital markets. So, I am especially interested in your testimony. I thank you for being here.

TESTIMONY OF DANIEL C. MONTANO, PRESIDENT, MONTANO SECURITIES CORP., LOS ANGELES, CALIF.

Mr. **Montano**. Thank you. You have made the airplane flight this morning worthwhile.

You have some copies of my prepared statement. I apologize in advance for the errors. My staff finished it yesterday while I was in another meeting.

I wish to express my appreciation to the chairman for the invitation to appear before the Small Business Committee to discuss important issues relating to the SBA 8(a) program for small socially and economically disadvantaged entrepreneurs. Small business, especially minority businesses, desperately need access to the capital markets to obtain adequate financing if they are to survive and prosper.

Before I address the question of capital formation for 8(a) companies and other small, disadvantaged companies, I would like to take a moment to submit my qualifications to testify before this committee.

I am a Mexican American born in east Los Angeles. I am 32 years old and have a bachelor's degree in accounting and finance from California State University at Los Angeles, and a MBA from the University of Southern California in finance. I received both of these degrees going to school full time, attending evening classes.

I taught accounting, finance, economics, and economic history part time for 7 years at Pepperdine University, the University of Southern California, and California State University at Fullerton. I have also worked full time in the securities industry since I was 18 years old.

I have worked in every aspect of the securities industry from the back office, the floor of the stock exchange, and institutional research, to syndicate and corporate finance. I have managed an investment securities firm for the last 6 years and publish a monthly letter on business and economics that goes to over 5,000 businesses throughout the Nation.

During my last 14 years in the securities business, I have raised over $200 million in capital for small- and medium-size businesses and presently serve as a member of the board of directors of six publicly owned companies.

Since starting my own firm, we have dedicated ourselves toward assisting small entrepreneurial companies need of capital. In starting our firm, 2½ years ago, my partners and I decided to establish ourselves as the investment banking experts for minority and disadvantaged companies.

Our firm has expended considerable time, capital, and personnel toward this effort. I believe I am qualified to testify on the subject, because of our own labor force consisting of over 50 people and, most importantly, our dedication to be the leading investment bankers servicing the minority business community.

The Small Business Administration has been studying the problem of graduation for companies that are in the SBA 8(a) program. Part of the study is to establish a definition as to what constitutes a mature company no longer considered to be disadvantaged.

I believe a part of the measurement of graduation has to be the financial solvency of the minority company. To ignore the financial solvency of any company, especially an 8(a) company in the SBA's graduation formula, would be imprudent and potentially destroy everything that has been done thus far for these companies.

The economics of the United States are based on a capitalist system. While Congress, through the SBA, has been attempting to assist minority-owned disadvantaged enterprises through the 8(a) program, all of their efforts are useless unless the program allows these companies to enter the capitalist system by obtaining capital.

In the United States, to elaborate, there are an estimated 22,600 publicly owned companies. To my knowledge, only one of these was originally owned by a minority. As long as minority companies are excluded from the capital markets, they cannot enter the capitalistic system.

No program to help minority-owned business can succeed unless that program takes into consideration the lack of accessability to the capital markets, experienced by small minority-owned companies.

The facts are simple. The U.S. capital market, or Wall Street as it is commonly called, has no known inclination to help minority enterprise succeed.

While the Congress of the United States has attempted to help solve the capital crisis experienced by all small- and medium-size businesses over the last 10 years, no effort has been made to coordinate these efforts with minority enterprises, such as these in the 8(a) program.

No matter what the revenue figures or profit numbers are, a company cannot survive without adequate capital. For example, in our efforts to assist minority-owned enterprises, we have run across several minority-owned companies that are participants in the 8(a) program. We have reviewed their financial condition as part of our efforts to assist them.

In every case, their financial condition could be defined as unsound or critical. Each company reviewed would fail within a matter of months without continued Government support. In every case those 8(a) companies' survival is hand to mouth, and each was in very difficult financial condition.

One very specific example was a minority-owned company that belonged to the 8(a) program with good sales and decent profits, but the company required Government advancements and grantees to stay in business because it had very little capital.

We explored the possibility of raising equity capital for this company by doing a public stock issue. The equity capital infusion would have made the company financially solvent and sound.

We negotiated with the owners and structured an acceptable deal. They proceeded to inform the SBA they were going to raise capital which would allow them to be financially solvent.

They were then informed by the SBA that if they were strong enough to go public and raise capital, then they were strong enough to be out of the program. Hence, they were forced to continue their participation in the 8(a) program and remain financially questionable and insolvent.

What I am attempting to address is that no 8(a) company can be graduated until it is financially sound, and no 8(a) company can become financially sound because it means automatic graduation.

The SBA has created its own self-fulfilling prophecy of corporate dependence on the 8(a) program. It has made it impossible for an 8(a) company to raise capital, and without capital they cannot survive without help.

In a capitalistic society a company must have capital to survive and prosper. Minority-owned companies start at a tremendous disadvantage in attempting to deal with Wall Street. The one Government program that helps minority companies to get started and develop is presently designed not to allow those companies to become financially solvent.

None of these companies can compete in the open free market without a capital base. Hence, any consideration of a graduation formula must consider some way to allow these companies adequate access to capital markets.

Your committee understands the problems are increased severalfold simply by being a minority-owned enterprise, and those problems are insurmountable now if those companies belong to the SBA 8(a) program.

You must address capital formation and access to the capital markets when you set your standards for graduation from the 8(a) program. Please keep in mind that the 8(a) program has helped some companies develop much faster than they would have otherwise, and without a comprehensive plan which allows them to get capital, they will disappear even more quickly.

I have addressed the problem of access to capital markets that a minority firm faces. Now let me address some possible solutions.

One, develop some methods which allows an 8(a) company to be rewarded for solving its capital problems and becoming financially sound, and hence capable of graduation.

Two, have an annual seminar for 8(a) companies on how to raise capital. In my experience, I have found a tremendous ignorance on how to accomplish this most important part of being a business in a capitalist society.

Three, develop a pilot program which will allow several 8(a) companies to raise public capital. There is only one successful minority-owned company that has ever gone public. Successful role models are critical if minorities are going to be brought into the capitalist system.

The 8(a) program has little value if the majority of its graduates go bankrupt, yet the 8(a) program has tremendous value if it sets as examples models for young minority enterprises to strive for.

I have been a minority on Wall Street for 14 years. I am the major stockholder in one of the three minority-owned securities firms in our Nation. I know the difficulty of building a business and the preppie school chum mentality on Wall Street.

Your minority-owned 8(a) companies don't need a handout, they just need a guiding hand. This committee must think of some way to remove the obstacles to obtaining the necessary capital for its 8(a) firms before it graduates them into the capitalist system. You cannot expect these minority companies to survive in the capitalist system without capital.

Thank you.

Mr. MITCHELL. Thank you very much. That is very impressive testimony. I will come back to you for some questions.

I am concerned about the catch-22 situation at SBA where if you go out and get capital, then you are strong enough to be graduated from the program.

I would like to check and see if that is done by kind of administrative law.

Mr. MONTANO. My understanding is that there is no set rule, but that when a company changes any of its ownership in any SBA program, they have to requalify. Hence, if you requalify, and you have capital, then you probably wouldn't qualify again because you are no longer disadvantaged.

So, no one has ever tried it. Everybody we have talked to, minority companies we have talked to, the second we start talking to them they say: "Oh, oh, we are afraid to try because once we get the capital we may not get back into the program, and if we don't get back into the program, we might violate the securities laws on full and fair disclosure now because we have just committed securities fraud because we didn't have what we thought we had."

Mr. MITCHELL. I have some more questions.

Congressman Addabbo?

I am delighted that Congressman Hiler has joined us.

Mr. ADDABBO. Thank you very much, Mr. Chairman.

I want to commend the gentleman on his statement and his appearance before the committee to give us his personal experience, which is very important.

In your first paragraph you state, "Small business, especially minority businesses, desperately need access to the capital markets to obtain adequate financing if they are to survive and prosper," which I fully agree with. Most of the 8(a) firms that we have seen fail is because there has been inadequate financing and capitalization.

In your experience in dealing with the 8(a) program, and with minority businesses, do you find in many cases that SBA would underfund just to get a number on the record; in other words, they would have helped another firm, but would underfund, and by underfunding they are actually causing the demise of an 8(a) firm or a minority firm?

Mr. MONTANO. I really can't speak to the SBA's funding situation. Our experience has been that of investment bankers, that saw a tremendous vacuum, and in that vacuum with the minority companies we thought we would have a chance to make some money.

I am greed motivated. That is the nice part about me. I am proud to admit it. When we started finding those companies, those that were 8(a) companies, none of them had capital. So I cannot talk from the SBA's point.

This is a phenomenon which we have run across which basically we find kind of appalling. Those companies which are starting to get to the point where they are becoming legitimate businesses cannot go to the capital market.

This year we raised about $15 million for companies. None of that was for minority enterprises. Although we probably have talked to five minority enterprises, none of them will come across that threshold because they are afraid they are going to lose their ability to compete.

So, I cannot speak from the SBA point of view. I can speak from our point of view. Everything we have seen has been terribly underfunded.

Mr. ADDABBO. In dealing with the small business firms, have you been able to counsel them or have they been able to receive the proper counsel to see whether or not they could in some cases subordinate DD money or other small business money so they could obtain money from the private market and possibly help graduate themselves out of the SBA program?

Mr. MONTANO. I think the answer is first of all everybody we have talked to has a difficult time believing it can happen because it has never happened before. To find an individual who has an enterprise that has put 15 or 20 years of his life into and then say risk it on going public and raising capital, making yourself financially solvent. While we in this room, it seems like a reality, to that person all they see is what they are giving up, and what they are giving up is the fact they have something today. No one has ever gone public. You have one minority company that succeeded.

Let me use an example. In Orange County, Calif., computers are a commonality. Every engineer with more than 5 years experience leaves a computer company and starts another computer company, and the venture capitalists throw money at them regardless of the perceived risk because the perceived rewards are there. They have a model to follow—so and so was successful—and everybody is willing to take a shot and risk their lives to do it.

In the minority community, you don't have any successful models. So when you sit down with these people to consult with them, and you keep talking about Shangri-la, it is a dream to them. If you talk about Wall Street or getting capital, they don't believe it can happen to them.

I can honestly tell you the five companies we have dealt with, we have spent inordinate amounts of time educating them and counseling them, and the bottom line is they don't believe it is going to happen to them. That is a fear which you cannot quantify.

I know that I can find a 28-year-old engineer in a computer company that is willing to chuck it all to go start his own computer company because he will be a billionaire someday, he is convinced.

But you cannot get a minority entrepreneur to believe that he has the same access to capital markets. So there is a tremendous problem there. That is one of the greatest difficulties we have faced.

Mr. ADDABBO. I think it points up a very important problem that the small businessman has, in that he does not have adequate counseling from SBA themselves. If he had adequate counseling there, he could then know whether or not he can seek your help in private investment and private funds.

Mr. MONTANO. Part of the way the SBA is set up is to help get debt capital. If you take an economic study of successful companies in the United States, very few of them borrow money.

It has been an interesting error that most people think successful companies borrow money. They do not. They get their capital from the equity markets. The SBA provides the debt capital, which is the wrong thing to provide companies.

Mr. ADDABBO. Thank you.

Thank you, Mr. Chairman.

Mr. MITCHELL. Mr. Daub?

Mr. DAUB. Should the Government, Mr. Montano, provide a loan program for capital? How do we access it? If you say we don't have a model role, to give them courage on their own, how are we going to provide them with enough of a carrot out there to attract them to have the courage to try?

Mr. MONTANO. Well, first of all, let me explain something. I am fanatically entrepreneur and capitalist. I don't believe in Government programs. Given that is where I am coming from, I think what we have right now is not that the Government should help these companies. I think the Government should remove some obstacle to these companies to get access to the capital markets.

This may come as a shock to you, but my firm still cannot deal with many firms on Wall Street. There are many internal rules and regulations which bar participation. There are three minority securities firms in the entire country.

I don't think that the Government should come along and give programs to provide them with capital. I think what the Government should do is remove the obstacles which allow those companies to show the private capital markets how to make some money.

Mr. **Daub**. Give me two or three specific examples of obstacles you are talking about.

Mr. **Montano**. I think No. 1 would be the apparent obstacle that if an 8(a) company can raise capital, that it is no longer an 8(a) company.

Now, you have some companies in that program that could be excellent models of successful minority companies that have gone from——

Mr. **Daub**. Let me pursue that with you. Are you sure that is the 8(a) rule as administered administratively by the Small Business Administration?

Mr. **Montano**. Whether it is the exact rule is irrelevant to the fact that the companies we talk to perceive it to be the rule.

Mr. **Daub**. Limit it then just to your own experience with some of the five you talked about.

Mr. **Montano**. Right. Every company we have talked to that has contacted the SBA has come back with the impression that they are putting their status at risk if they raise capital.

Now, the additional burden that presents to us—my understanding is that they cannot—if they change their ownership, then their status as an 8(a) company becomes in question. They have to reapply.

Mr. **Daub**. You are saying that that is the impression of your five clients?

Mr. **Montano**. That is their impression. Now, my perceived impression is I have a securities problem. If I raise capital for a company under the Securities Act of 1933 based upon what is the truth, and that part of that risk is an unknown, that that is that the SBA may or may not decide this company can reenter the program, then I have committed securities fraud.

Mr. **Daub**. Have you independently, as an investment banker with a staff of 50 people, investigated the rules and regulations to determine whether or not if those are SBA's rules, you would have a securities violation?

Mr. **Montano**. Well, I met with the new head of the SBA about 1 month ago or 6 weeks ago. I met with some staff at the SBA. Their response was that that was a very interesting question, that no one really has addressed the answer.

Now, the original question proceeded before Mr. Cardenas—when the incidents occurred. When there was a change in administration, I came back to clarify the question. The meetings that I had with the different personnel at the SBA basically revolved to the following; that is, "Bring in something and we will let you know."

Now, the difficulty there is now I am supposed to go back to a minority-owned enterprise and say, "Listen, let me take in your story and see if I can get the SBA to let you be a pilot one." They are deathly afraid.

Mr. **Daub**. Mr. Montano, I am going to find out for you.

Mr. Montano. I appreciate that.

Mr. Daub. Now, any other obstacles?

Mr. Addabbo. Will the gentleman yield just a minute because this is precisely the instruction I was going to give to staff. We have got to get this area cleared up. If somebody is making up rules as they go along, or there are no rules to govern that situation, then I think we need to know about it.

Mr. Daub. Fine. I will be happy to assist the chairman or staff in any way. Let's find out the answer.

Any other obstacles you can think of just from your experience or observation that stand as impediments, as you testified earlier, that could be removed?

Mr. Montano. I have about 4 hours' worth of testimony on that subject.

Mr. Daub. Do you want to write down your ideas, list them 1 through 30, and submit them to us so we can have some of your flow of ideas as food for thought? We are going to end up doing what we can to modify 8(a) and improve and strengthen it. At least that is my hope will be the result of this committee work.

So, we need your ideas. We don't have 4 hours right now, but we need your ideas.

Mr. Montano. I appreciate that. I think that your original question, though, was——

Mr. Daub. Impediments to capital access.

Mr. Montano. Which is not just the 8(a) program. You have to recognize that Wall Street, the financial markets of the United States, out of necessity has a very interwoven chummy attitude, because when you are dealing with money you have to deal with trust and you have to know people you trust. It is extremely difficult to break into that mentality. I can tell you in 14 years I am not sure I have made it yet.

Mr. Daub. Well, if we knew some of the things you knew, then maybe we could do some other things and wouldn't have to have as many 8(a) businesses as we might think we need, if we could break some of the capital entry access problems you are talking about.

Mr. Montano. There are a lot of self-imposed rules within the industry which exclude small and minority firms. Just one example. Most major firms will not allow their brokers to sell stocks in certain companies, as an example, under $10 market price. That is an internal rule that a lot of firms have.

Now, if a company comes to us and wants to raise $3 or $4 million we need enough shares out in the public market to establish a fair and equitable trading volume which means the price is going to be somewhere between $4 and $7 a share, which means automatically 70 percent of the brokers in the United States cannot participate in that issue, even if they wanted to.

So there is a longer series of lists which would be my gripe session. But I don't think that is exactly what you are here for.

Mr. Daub. Capital access is where we are trying to focus right now. If you have ideas, please feel free to submit them. Thank you for your testimony.

Mr. Mitchell. The Small Business Administration is seeking to graduate some 47 minority-owned firms from the 8(a) program. These firms, to the best of my knowledge, have been good firms.

They have shown growth, and so forth. I would also suspect that they would face the same problem in terms of access.

Based on your testimony, what do you think would be the fate of those 47 firms that are proposed for graduation?

Mr. MONTANO. Well, from what I have seen, the financial statements that I have looked at, at the companies that are members of the 8(a) program, I don't think one of them will last 6 months of the five that I have seen.

I am not being derogatory, but there is not one of them that isn't hand to mouth, current ratios are the pits—I am sorry——

Mr. MITCHELL. It is a familiar term.

Mr. MONTANO. It is totally appalling. You have to recognize, some of that is a self-fulfilling prophecy. You allow these companies to obtain business, but you don't allow them to obtain capital.

Now, if I am on the board of a company that is in a high growth situation, and growth consumes capital, we look to raise $5 million if we anticipate doing $10 million in sales next year. A company to turn its capital three, four times a year is a phenomenal turn.

You have some 8(a) companies that are turning their capital 20 and 30 times. I mean, it is impossible—without Government advances, without—if the banks—and I am not being derogatory—but if the banks loaned them money on the basis other than the fact that they knew that the Government was guaranteeing the business and the payments, they wouldn't last.

Mr. MITCHELL. Then I guess the bottom line for me is that if this forced graduation goes through, and I hope that it doesn't, it would mean that the total amount of time and money invested in those 47 firms on the part of the Federal Government will go down the drain within let's say 1 year.

Mr. MONTANO. I would say that in my opinion that is the absolute case. The same as what would happen if the U.S. Government didn't guarantee Chrysler's loans.

Mr. MITCHELL. Mr. Hiler?

Mr. HILER. Thank you, Mr. Chairman.

I think you bring up an interesting dilemma.

One of the subjects of all the hearings we have had has been the graduation and how we should go about achieving that graduation. You mention in your testimony "financially sound as a basis for graduation." What criteria would you use for determining financially sound?

Mr. MONTANO. Well, I have made a living in high technology and growth situations. You have to measure the cash flow needs of a company to finance its growth, et cetera, et cetera, depending on the industry, the margin, et cetera, et cetera.

But the bottom line I think comes down to one very simple fact; that is, that a company should have the basic ratios that we all learned when we first took accounting; that is, a current ratio of 2 to 1, debt ratio not more than 50 percent, very basic things.

None of these companies have that, not a one that I have seen. If you don't have—let me put it this way. There is not a company in the Fortune 500 that doesn't get rated by Standard and Poor's as far as their financial solvency.

A company with a D rating, which is on the verge of bankruptcy, is 10 times better off than any 8(a) program company I have seen today. I haven't seen all of them, but I have to assume—the company being started with a minimal amount of capital.

A person starts getting a tremendous amount of business. The entire orientation of the SBA, either the procurement side or on the debt side, debt capital on one side and business on the other side.

The equity base remains marginal at best. It takes 3 to 5 years to develop a management team; that is, coming from the venture capital side, you go out and pick the best in every industry and pull these people together. It still takes 3 to 5 years.

Some of these companies in the 8(a) program truly don't have financial officers. They have a person that is there, but to be a financial officer in a company doing $1 million in sales is totally different than a person doing $7 or $12 million.

So I guess what I am saying is that the need for capital is the thing that is really lacking in those companies.

Mr. **Hiler**. If I could follow that, is there a general shortage of equity capital today for all small businesses? Is it spotty or widespread?

Mr. **Montano**. I wouldn't say it is spotty. If you are in Silicon Valley or in California, in your high technology, they will give you $10 million if you can spell your name correctly.

The financial markets are fadish. They run hot and they run cold. Right now there is a tremendous amount of venture capital out. In fact, there is so much venture capital out, and I think in the last 6 months there have probably been more new issues than in the previous 5 years.

It has come back a great deal. It is spotty, but it depends on the industry. If you are going to go into medical electronics or robots, no problem raising money.

Mr. **Hiler**. To follow up on the graduation issue, do you think that there should be certain financial criteria that should be met? Would you say that they should be met in a certain amount of time?

SBA has come up with a proposed regulation which would require graduation in a 3- to 5-year time period or something of that nature. That may be too quick. It may not be quick enough. Without talking about the specific regulation, do you think that there should be some type of time orientation? The program has been in effect for 8 or 9 years and you say that you have never seen an 8(a) firm that should be graduated.

Mr. **Montano**. I didn't say should be. I said couldn't be. There are some that probably should be. They just cannot be. I don't mean to be splitting hairs. There are some of these companies that I believe if they had their capital problem solved could be capable of graduating.

What I am saying is that some of them should be. But right now, if you did, they would be gone. I don't mean to be splitting hairs.

Mr. **Hiler**. OK. Well, how long do you think someone should be in an 8(a) status? Presumably, you could go for 10 or 15 or 20 years without getting your capital base.

Mr. **Montano**. What I am saying is let's take 8(a) and just ignore that because I think that is a moot point. Your question really is how long does it take for a company to mature. If one of those companies happens to be an 8(a) company, the same qualifications apply.

When we go out and we finance a company from a venture basis, and we are putting in hard equity, top-notch management, we know where we are going, we are looking at 5 to 8 years, if everything goes right.

Now, if things don't go right, you are looking at 15, 20 years. Now, that is the top-flight situation. That is going in with a ton of equity capital and with pros all the way.

Now, when you ask me how long should a company in the 8(a) program, my answer has to be—let's assume for the sake of discussion, I use my analogy, a bonus—give a company a bonus for getting out of the program. Everything I basically heard about the program is how do we punish somebody for staying in it. That has been the attitude and mentality I have seen.

My question is, in business, at least in the businesses I am involved in, we tell the president you make $1 million for the company you get a bonus. We tell the stockholders, if we do well you get a bonus. People are greedy animals, those in business, I should say. They pursue bonuses.

Mr. HILER. We are all in one business or another.

Mr. MONTANO. I am glad you said that. My point is that we have an 8(a) company, you say how long should it be in the program. Why don't you make it designed so that they want to get out of the program because it is rewarding to them.

Now, you have some companies that are capable of going to the capital markets now. I am saying in the next 6 to 12 months. If those companies are able to go to the capital markets, they would be designing themselves to graduate.

So I guess what I am saying is I cannot tell you if that time frame in the 1980 program is 1 year—I can tell you right now, I know some guys I think if they started a company tomorrow and were in the 8(a) program for 2 years, and started with $5 million capital and got the right programs, they could graduate in 2 years. They have done it before. Not in the 8(a) program, but these guys are professionals.

You give me somebody who is truly a virgin entrepreneur, who is going to have to learn everything the hard way, maybe two or three times, and who is going to be in an area where they compete against Northrop, that is a different animal.

So, I don't think you can sit there and say all kids grow up the same. Some of us grow up faster and some slower. My wife still thinks I am a baby.

Mr. HILER. Thank you.

Mr. MITCHELL. I really do have additional questions and I am certain the other members do and I would ask unanimous consent that all members would be able to submit additional questions to you.

[Questions for Mr. Montano follow:]

QUESTIONS TO BE SUBMITTED FOR THE RECORD DIRECTED TO MR. MONTANO

The Small Business Administration attempts to discuss the 8(a) program as a single unit. However, in the private market place, there are different criteria for each industry classification and for many of the sub-industry classifications. For example, what are the standard criteria for a high technology firm to move into the

Wall Street market for capital? Please provide three or four examples of industries with an illustration of the life-cycle the industry must go through in order to reach a level of viability and credibility to penetrate the lowest level of public offerings. Likewise, please discuss the impediments such firms may encounter in purchasing supplies, credit, etc., before reaching such level of viability.

Mr. MITCHELL. Your testimony has been very provocative.

Just from the top of my head I am thinking in terms of a transition program where the firm moves from an 8(a) status into some other kind of status not totally free of Government support but it seems to me we could fashion something like that, then deal with the matter of reward, then deal with the matter of breaking into the capital markets with some help. That is one possibility.

Mr. MONTANO. I think you have a carrot-and-stick opportunity presented to you now. The stick everybody is talking about is graduating them. The carrot should be the offset, and that is if you solve these capital problems then you have *x* amount of period before you graduate.

So that you say to somebody, if you don't solve your capital problems, you are out after a certain period of time, whatever time frame that be, but you have a chance to compete with a Northrop. If you really want to be in business, you will solve your capital problem and you get a chance to compete a little longer.

Mr. MITCHELL. In that connection, if such a mechanism can be developed it seems to me we would have to play around with the 51 percent minority membership which is a criterion.

Mr. MONTANO. It is not really a problem.

Mr. MITCHELL. It is a problem in that according to present rules and regulations once that percentage changes it is no longer a minority-owned firm. But I think we can develop some kind of transition phase where ownership can be added onto without jeopardizing the firm.

Mr. MONTANO. I would think that when we look at financing the company we look at taking 30 to 40 percent to the public markets. The reason is there has to be enough goodies left for the person supposed to crack their back so they can get rich. The 51 percent has not been an obstacle to us.

The No. 1 obstacle and the easiest thing for this committee to resolve is the gross ignorance that exists on what capitalist markets are like. If you had a few greedy capitalists explain to 8(a) companies how you get there—these people do not understand and they are scared to death.

We sit down with them and they are convinced—it is a nightmare to them.

Mr. MITCHELL. I will submit questions to you. I will tell you what one is. How in the world does the Government break the prep school chum mentality that exists on Wall Street?

Mr. MONTANO. You get them socks.

Mr. MITCHELL. Our next witness is Mr. Leonard Fuller, Ferguson-Bryan & Associates, Inc.

I always worry when I ask people to come in to testify because I know what a day away from the shop might mean but we do appreciate your accepting our invitation.

TESTIMONY OF LEONARD R. FULLER, MBA, FERGUSON-BRYAN & ASSOCIATES, INC., WASHINGTON, D.C.

Mr. FULLER. Mr. Chairman and members of the subcommittee:

I am Leonard R. Fuller, a principal with the management and technical consulting firm of Ferguson-Bryan & Associates.

Thank you very much for allowing me this opportunity to testify on an assignment that our firm undertook under the auspices of the Small Business Administration office of 8(a) eligibility.

The primary purpose of the assignment was to identify financial and economic criteria which the SBA could use to develop a uniform basis for making decisions concerning 8(a) program eligibility, completion, termination, and retention.

Before I describe our study, I would like to give you some background information on Ferguson-Bryan & Associates and the team of consultants who were responsible for the assignment.

Our firm, which is 8(a) certified, was founded in October 1978 by individuals who are highly skilled consultants and were previously principals with major consulting firms.

Specifically, Mr. James Ferguson was a principal with McKinsey & Company, Inc., and Mr. Alfred Bryan was a vice president with Booz-Allen & Hamilton, Inc.

The staff that worked on this assignment in my opinion was uniquely qualified. We had a Mr. Haskell Arnold, a CPA who earned his MBA from the Harvard Business School and has worked for various small- and medium-sized businesses in senior management positions.

I would like to add parenthetically a number of our members have gone to prep schools but we don't consider ourselves preppies. Hopefully, we have hands-on experience in small business management.

Mr. MITCHELL. The preppie remark was related only to the Wall Street operation.

Mr. FULLER. Thank you very much.

We also have Mr. Jonathan Mariner, a CPA and graduate of the University of Virginia and the Harvard Business School; and Mr. George Cato who has an undergraduate degree in economics from Morehouse College and an MBA from Atlanta University.

My own background includes a B.A. in public administration from the University of Southern California and an MBA from the Harvard Business School.

Additionally, I have taught small business management on the university level at California State Polytechnic University.

Prior to moving to Washington, D.C., in 1978, I was a marketing executive with one of our Nation's largest aerospace companies.

Now to our study. The basis for this study was Public Law 95-507. As you are aware, Public Law 95-507 mandated the use of section 8(a) authority for the development of businesses owned by socially and economically disadvantaged individuals.

Although Public Law 95-507 provided a clear definition of what constitutes social disadvantage, it did not, according to the Small Business Administration, specifically define economic disadvantage.

The absence of this criteria, as we have heard from other witnesses this morning, has led to the SBA applying arbitrary and in some instances inconsistent rulings to companies who were being considered for eligibility under the program or considered for graduation.

To this end the Associate Administrator for Minority Small Business asked Ferguson-Bryan to attempt to come up with some uniform criteria for entry and exit from the 8(a) program.

The concept of such a study was also recommended by the SBA Inspector General in his September 1979 eligibility review of 8(a) firms.

The specific objectives of this assignment were threefold:

One, identify economic and financial criteria which are consistent with the legislative intent of the 8(a) program set forth in Public Law 95-507.

Two, provide a basis from which consistent assessments of the relative economic disadvantage of firms seeking entry into the 8(a) program could be made.

Three, set initial benchmarks for use in periodically measuring the development of firms in the 8(a) program and their relative degree of economic strength compared to similar businesses owned by nonsocially and economically disadvantaged individuals and I emphasize relative degree.

As you are aware, Mr. Chairman, Public Law 96-481 was promulgated into law in October 1980, which was after our research had been completed.

Although this law mandates the negotiation between the SBA and portfolio companies to determine specific periods of time for participation in the 8(a) program, we believe that it can work hand-in-hand with Public Law 95-507, if it is implemented in the proper spirit.

In fact, we see the two laws as being compatible based on their mutual emphasis on business development prior to graduation.

However, we are concerned that the regulations for implementing Public Law 96-481 may be somewhat consistent with the spirit and intent of both Public Law 95-507 and 96-481, since it bases graduation on what appear to be arbitrary time limits on program participation, without sufficient regard to business development.

At this point I will summarize our major findings on this assignment.

One, the basic economic conditions which prompted the passage of Public Law 95-507, in our opinion, still existed, for example, in 1977, gross revenues of minority businesses amounted to only 2.7 percent of all businesses in this country, and minority businesses received only 3 percent of all Government contracts during that same period.

Two, SBA had no consistent basis for determining eligibility for or preparedness to complete the 8(a) program.

Three, insufficient emphasis on the business development aspects of the 8(a) program.

Four, decisions concerning program entry and evaluation were characterized by over-reliance on single factors, lack of data to support decisions, and subjective judgments by SBA personnel.

We believe that many of the findings mentioned above actually militate against business development, Mr. Chairman.

In an attempt to assist the Small Business Administration in ameliorating these situations and coming forward with objective decisions we developed what has been called an economic model and I will put that in quotes because it is not a true economic model but rather a set of economic criteria used in making judgments concerning participation in the 8(a) program.

This set of criteria are characterized by several factors:

First, separate criteria exist for each of three major industry groups: manufacturing; construction; and professional/nonprofessional services.

Second, guidelines have been established for determining the relative economic status of firms and their owners vis-a-vis businesses of similar size and industry groupings, with respect to program eligibility and 8(a) participant evaluation.

Another characteristic of our recommended criteria involves weights that reflect the relative importance of each criterion to businesses owned by nonsocially and economically disadvantaged individuals.

I would like to list the five major groupings we have determined for purposes of this study.

One, personal financial condition.

The personal financial condition of a firm's owner(s) would be evaluated to establish relative degree of economic disadvantage in comparison to other individuals in the economy at large, as well as their potential to capitalize or otherwise provide financial support to the business. The specific factors contained in this section are the following: income, assets, and net worth.

Two, access to credit and capital.

This group of criteria evaluates the ability of the business and, by inference, the individuals who own it, to obtain the external financial support necessary to operate a viable business enterprise.

The factors contained in this section are: long term financing; working capital financing; trade credit equipment; trade credit for raw materials and/or supplies; and penetration of desired markets.

The third, major grouping business development assessment. This group of criteria is applicable only to participant evaluations, that is, program completion. The factors contained in this section of our report are those which measure the outside marketing and internal development of a firm.

Additionally, this section takes into account the length of time a firm has been in the program. However, I would like to emphasize we do not believe under any circumstances time alone is sufficient to warrant program completion.

Some of the factors that would be considered in this major grouping include:

Percentage of 8(a) sales to total sales to determine the level of dependence on 8(a) contracts. In addition, this factor is designed to provide a positive incentive for obtaining non-8(a) business.

Attainment of initial business plan goals to measure current performance against prestated business plan goals.

8(a) sales trend by number of years in the 8(a) program to monitor business development vis-a-vis length of time in the program.

The fourth major grouping is business financial conditions. This category is designed to conduct analysis of the relative business strength of any particular concern. It addresses so many of the concerns of our previous witness concerning key ratios. We have identified 10 what we consider to be 10 ratios.

Current ratio; quick ratio; inventory turnover; number of days receivable; sales to working capital; return on assets; debt to net worth ratio; percentage return on investment; percentage gross profit margin; percentage return on sales—profitability.

Where a company would be measured against nonsocially and economically disadvantaged businesses to see how they measure up in those areas.

Business financial trends is the next.

This component of the criteria measures the financial development and growth of a company over a 3-year period of time.

Taken together, we believe these five groups of criteria would provide the SBA with the basis for making objective and consistent decisions regarding participation in the 8(a) program.

However, in all cases we strongly suggest that the SBA conduct a thorough review with allowances being made for nonquantifiable factors.

I don't want to suggest by any means that you can drop something in the computer and it will come out green, red, or what have you.

We have attached a sample copy of one of the sets of criteria, Mr. Chairman, we have developed what we have called supplemental recommendations.

I would like to briefly mention a few of those at this time.

First and foremost we think the SBA should implement a policy precluding length of time as sufficient basis to determine degree of competitive viability.

Mr. MITCHELL. As the sole denominator?

Mr. FULLER. Yes, as a sole determinant.

In our opinion, this speaks more to business maintenance than business development. If our purpose is to maintain a business we could say 1 day, 6 months, 100 years in the program. But if we are talking about truly developing businesses which I understand is the purpose of the program, I see no way in my business judgment we can arbitrarily put a length of time on that.

The second supplemental recommendation: Provide business development specialists and other appropriate personnel with comprehensive training on the implementation and use of the criteria in this report as well as other functional areas of business such as accounting finance marketing, and general management.

Require firms in the 8(a) portfolio to maintain realistic business plans that could be used as benchmarks for developing the extent of business development;

Improve the quality and timeliness of technical assistance available under 7(j) of the Small Business Act;

Develop an equitable phaseout program for firms that have been deemed ready to complete the 8(a) program;

Propose program assistance to portfolio companies that have already completed the program;

Establish guidelines that would allow companies to be considered for reentry into the program, assuming or allowing for the possibility that the firms could not make it in the open market.

Mr. Chairman, these economic and financial criteria for participation in the 8(a) program resulted from 12 months of extensive interview, a review of relevant literature, and an analysis of financial data on 8(a) portfolio companies and small businesses in general.

We believe they reflect sound business judgment and that they are consistent with the spirit and intent of prevailing Federal laws.

It is our view that the conditions which led to the development of the 8(a) program and Public Law 95-907 still exist today.

That is, minority businesses still do not participate fully in, or have an equal access to, the economic mainstream of this country.

This situation extends beyond the normal economic forces that often inhibit the formation and growth of new businesses.

We believe there is great value in the 8(a) program because it has provided access to business opportunities for thousands of socially and economically disadvantaged companies at modest cost to other taxpayers.

The Government, in return, has received, and continues to receive, high quality goods and services for contract dollars spent.

Accordingly, we believe SBA, with the support of Congress, should continue its efforts to implement the minority business development intent of Public Law 95-507 and Public Law 96-481 in a consistent, constructive, and equitable manner.

Thank you, Mr. Chairman, for allowing me to testify on this most important subject.

Mr. **MITCHELL.** Thank you very much for your testimony. I was somewhat familiar with your study, as you know. I am curious. I think you have made many excellent recommendations. This was at the request of SBA that the study was done.

Mr. **FULLER.** Yes.

Mr. **MITCHELL.** Do you know to what extent, if any, SBA has decided to implement some of your recommendations? What I am saying is obviously this forced graduation flies right in the face of what you recommend.

Mr. **FULLER.** It is our understanding that they were considering implementing certain aspects of our recommendations. As a matter of fact, we were working with them. But as obviously the new regulations indicate, another course has been taken at this time.

Mr. **MITCHELL.** One of the criticisms that I have heard fairly frequently in this committee is that a relatively small number of 8(a) firms get disproportionate share of 8(a) contracts. Based on your study, is that essentially true?

Mr. **FULLER.** The purpose of our study was not to concentrate on the numbers of firms or the percentages of contract dollars they received so I don't think I am truly qualified to speak to that.

However, I would like to add that business is business and obviously a company that is more developed is going to get more contracts than those companies least developed.

If that is the case I think the onus is on SBA to assist in developing some of those companies that are smaller.

Mr. **MITCHELL.** That could be more competitive?

Mr. **FULLER.** Yes.

Also, I would like to add that the SBA apparently has a policy of giving bonuses for attaining certain goals and it was our understanding in going out to the various regions in the country, which we attended 8 out of 10, that the SBA personnel felt more comfortable in dealing with people who had proven track records rather than attempting to do business with someone who had not because bonuses and other things were on the line.

Mr. MITCHELL. That modus operandi would contribute really to the smaller number of firms getting the disproportional share.

Mr. FULLER. I would think so.

Mr. MITCHELL. I have to ask you: You are aware of the proposed graduation of 8(a) firms and I want to put the same question to you I did to Mr. Montano if you will address it.

Based upon your study, if there is a forced graduation of some 47 minority firms—and I hope that does not occur; I think it is nonsensical to do it—but what, in your opinion, would be the status of those 47 firms after 6 months or 1 year or 18 months?

Mr. FULLER. I think it would be very difficult under the most ideal circumstances for them to compete in the open market.

I don't think you take a company out of a sheltered market and move it into a competitive arena overnight. I think it would take a period of time at best.

Mr. MITCHELL. One of your recommendations is firms that would be phased out of the 8(a) program is the establishment of separate category of small business set-aside contracts wherein former 8(a) member companies could compete among themselves.

Do you know whether the SBA has looked at that recommendation at all?

Mr. FULLER. They have looked at it and we have discussed it. I don't know at this time what the status of their thinking is on it but certainly we have discussed it. Each of these recommendations, Mr. Chairman, was developed in concert with various authorities at the SBA.

Mr. MITCHELL. Just one last question from me.

On page 11 in your testimony you mention some degree of review and subjective input before a firm graduates from the program.

I agree, you just can't punch all this into a computer and say this one graduates and this one does not.

I would like you to elaborate a little on the subjective input.

Mr. FULLER. First of all, it must be tied to a greater activity. We think the business development specialist and other individuals who are charged with the responsibility of reviewing the 8(a) portfolio or maintaining it should be well versed on what is going on in that business, well versed and accounting principals.

Once a company comes up for review the responsibility rests with that business development specialist to know what is going on inside those corporate doors, not just what the numbers portend.

Also, to make sound business judgments based on the numbers, the way we have laid out our criteria is that companies would be placed into one of three categories: First, admittance strongly suggested; second, a period of review is recommended; and third, admittance would not be recommended.

In each of those cases we say there could be extenuating circumstances, that there could be certain situations the model would not pick up, therefore, qualitative business judgments would be more appropriate.

Mr. Mitchell. Thank you very much.

I will also submit some additional questions to you for response.

Mr. Fuller. Thank you very much, Mr. Chairman.

Mr. Mitchell. Our next witness is Mr. William Mathis, the Acting Director of the Office of Federal Procurement Policy. We have met before; we have talked before. We are delighted to welcome you back before this committee hearing.

If you care to introduce the persons with you, that would be fine.

TESTIMONY OF WILLIAM MATHIS, ACTING ADMINISTRATOR, OFFICE OF FEDERAL PROCUREMENT POLICY, OFFICE OF MANAGEMENT AND BUDGET, ACCOMPANIED BY BETTY BROWN, DEPUTY ASSISTANT ADMINISTRATOR FOR PROCUREMENT FACILITIES, AND OWEN BIRNBAUM, DEPUTY ASSOCIATE ADMINISTRATOR FOR REGULATORY PRACTICES

Mr. Mathis. Good morning, Mr. Chairman. I have with me Betty Brown, the Deputy Assistant Administrator for Procurement Practices and Mr. Owen Birnbaum, Deputy Associate Administrator for Regulatory Practices.

Mr. Mitchell. We have a copy of your testimony. You may proceed by reading it all or you may submit it in its entirety for the record and just highlight your testimony.

Mr. Mathis. I will elect to read it. We were late in getting our statement prepared so I would like to read it in its entirety.

Thank you for inviting me to testify regarding the establishment and assessment of minority procurement goals.

It does seem appropriate, at the beginning of a new administration and a new term of Congress, to discuss with you OFPP's statutory role with respect to Government procurement in general, and particularly to share with you our views on OFPP's role under Public Law 95-507. I would like to note at the outset that we believe that improving minority business participation in Federal procurement is a matter of great signficance. We will try, this morning, to explore methods to better achieve that objective.

The statutory responsibility of the Office of Federal Procurement Policy is set forth in the Office of Federal Procurement Policy Act of 1974—Public Law 93-400—as amended by the Office of Federal Procurement Policy Act Amendments of 1979—Public Law 96-83. Public Law 93-400, as amended, in establishing this office declares the policy of Congress "to promote economy, efficiency, and effectiveness" in Federal procurement. Specifically identified as methods of achieving such "economy, efficiency, and effectiveness" are the achievement of "greater uniformity and simplicity" in procurement procedures and the coordination of the "procurement policies and programs of the several departments and agencies." The 1979 amendment to our statute requires the Administrator to develop a "uniform procurement system to include uniform policies, regulations, procedures, and forms to be followed by executive agencies." Almost the entire effort and resources of OFPP are presently engaged in developing such a system. Uniformity of procurement practices and procedures is thus a central charge and responsibility of this office.

The need for OFPP to concentrate its efforts on achieving a simplified and uniform procurement system was sharply highlighted by the May 15, 1979, report— No. 96-178—of the House Government Operations Committee. In that report, among other findings, the House Committee concluded that OFPP:

> Has devoted an inordinate amount of its resources to matters which at best are ancillary to its basic procurement responsibilities, and which at worst exceed its statutory authority.

We have taken seriously the committee's criticism and refocused our attention and resources on the full range of responsibilities assigned to us.

OFPP activities under Public Law 95-507, while important, represent only a small part of our overall effort. OFPP policy letter 80-2, as revised, sets forth uniform procurement policy for the implementation of section 211(K) of Public Law 95-507, requiring that agencies establish offices of small and disadvantaged business utilization and No. 80—6, implemented section 221(J) of Public Law 95-507, covering small purchase/small business reservations. Guidance to agency procurement personnel and contracting officers on the subcontracting program has been provided in regulations covering all Federal procurement activities.

With respect to goal-setting procedures under section 15(G) of the Small Business Act, OFPP has the duty to resolve disagreements between procurement agencies and the SBA in the establishment of specific goals. These goals involve:

> Participation by small business concerns, and small business concerns owned and controlled by socially and economically disadvantaged individuals, in procurement contracts having values of $10,000 or more.

Section 15(G) requires that these goals:

> Realistically reflect the potential of small business concerns and small business concerns owned and controlled by small and economically disadvantaged individuals to perform such contracts and to perform subcontracts under such contracts.

On July 10, 1980, OFPP issued a memorandum entitled "Guidance on Goal Setting Under Procurement Preference Programs" for all executive agencies. This memorandum was developed by OFPP to avoid having several agencies issue separate letters on goal setting for fiscal year 1981, and to insure that the same procurement base was used for all the goals.

This guidance covered, in addition to goal-setting under section 15(G) of the act, the establishment of goals for women-owned businesses—Executive Order 12138, May 18, 1979—and goals for awards to businesses in labor surplus areas—Executive Order 12073, August 16, 1978. The July 10, 1980, memorandum also afforded guidance with respect to procurements under $10,000 from small and small disadvantaged business, awards to traditional minority educational institutions, nonprofit organizations operated and controlled by small and economically disadvantaged individuals, and awards to large business concerns owned and controlled by such disadvantaged individuals.

Recently, OFPP agreed with the Small Business Administration that they would initiate, for fiscal year 1982, the goal-setting process under section 15(G). SBA will, of course, proceed to negotiate the "15(G)" goals with the departments and agencies. It is our understanding that SBA and GSA, in accordance with their responsibilities, are developing a memorandum to be sent to the agencies covering, in a comprehensive fashion, goal-setting under most of the procurement preference programs covered in the July 10, 1980, letter.

I earlier stressed the central purpose of our enabling statute to put in perspective the approach that OFPP is following in compliance with its responsibilities under section 211. OFPP's statutory role is, as noted, one of resolving disagreements in establishing goals. The programmatic responsibility of assuring that small and small disadvantaged businesses receive appropriate and fair shares of Federal procurement resides with the Small Business Administration under the Small Business Act of 1958, as variously amended including the Public Law 95-507 amendments.

These goals led to poor procurement practices and poor procurements. In its reports of April 8, 1981, the General Accounting Office made the following critical observations relative to the 8(a) program:

> GAO believes that several interrelated factors have limited the program's effectiveness. The major factor is the President's yearly 8(a) goal imposed on SBA, which has become the dominant force behind the program and has clouded its intended goal of developing competitive disadvantaged firms.
>
> The award of increasing amounts of 8(a) contracts has become the single most important measure of the 8(a) program's success. Region and district officials generally agreed that the contract volume goals are contrary to the business development objectives of the program.

GAO concluded:

> SBA's main concern has been in achieving 8(a) contract volume goals imposed by the President, which has become the driving force behind the 8(a` program and competes with and clouds the program's true purpose—developing independent disadvantaged entrepreneurs.

Fiscal year 1981 goals were also established for direct contracts to minority firms, over and above those awarded under 8(a). I should point out that operating personnel had little or no influence over their achievement of these goals.

We would suggest that the SBA in all its future negotiations with the agencies be mindful of GAO's sound observation that unrealistic goals are counterproductive. Further, contracts placed with the principal objective of meeting preset overall goals may not be contracts in the best interest of the Government, or even in the best interest of the contractors involved.

As we carry out our responsibilities we intend to encourage SBA and the agencies to base their goals on an analysis of the potentiality and availability of sources to supply goods and services of the quality needed by the Government. Experience has shown that goals set in the preset context of automatically doubling and tripling earlier accomplishments do little to promote confidence in the goal-setting procedure. Goals set by SBA and the agencies should help to insure that minority business becomes a part of—rather than apart from—the Federal procurement process. Only with these steps can the real business at hand, the development of minority business, take place in the desired manner.

In closing, I want to note that our enabling statute includes a specific requirement to consult with the SBA and other agencies in developing policies, regulations, and procedures. We will aggressively pursue this responsibility. We have discussed with the SBA our views on goal-setting, and are available at any time to discuss the implementation of Public Law 95-507, its impact on improved minority business participation in Federal contracts, and any improvements that might be made to further this objective. The responsibility placed on SBA is an important one. We will continue to work with SBA in doing our part to achieve effective and productive programs for small and small disadvantaged business.

Thank you, Mr. Chairman. That concludes my prepared remarks. I will respond to any questions you or any member of the subcommittee may have.

Mr. MITCHELL. Thank you for your testimony.

Prior to some of the laws that are now in effect and prior to goal setting one would have to assume minority firms were, in your language, a part of the Government process.

Is that correct?

Mr. MATHIS. That is right. The only way they could get contracts would be through the competitive process.

Mr. MITCHELL. Then prior to these laws, prior to the goal setting, as I recall, for a number of years minority firms got less than one-half of 1 percent of all Government procurement contracts.

Is that correct?

Mr. MATHIS. I am not aware of the statistics. That is probably correct.

Mr. MITCHELL. Probably pretty close. Yet, they were a part of the regular procurement process. If that is true—and it is—how do you explain the miniscule participation of minorities in achieving contracts?

Mr. MATHIS. The point that I was trying to make then——

Mr. MITCHELL. No. I understand your point.

My question is that was the situation that obtained, less than one-half of 1 percent before we had laws and goals yet they were considered a part of the regular procurement process.

Mr. MATHIS. Correct.

Mr. MITCHELL. How do you explain their very limited participation if they were a part of the process?

Mr. MATHIS. I cannot explain all the rationale of why they got only one-half of 1 percent. It could be they were not pursuing Government contracts. There could be a myriad of reasons.

Mr. MITCHELL. Could it be pursuing and they were rejected?

Mr. MATHIS. I am sure there were a number of cases where they were unsuccessful in the competitive process or even in obtaining sole-source procurement.

Mr. Birnbaum has a comment.

Mr. BIRNBAUM. This was, of course, before Public Law 95-507 which the OFPP has been quite active in helping to implement.

Section 211, of course, is the subcontracting provision of Public Law 95-507.

I should add, OFPP had published in the Federal Register, previously, its own version which was very similar to the one that ended up in the public law.

So I think the attention that has been called to the minority business and the small disadvantaged programs in Public Law 95-507 has helped to overcome the unfortunately low percentage that existed before Public Law 95-507.

Mr. MITCHELL. Believe me, I am not denigrating OFPP. I think because of your testimony we need some clarification. You said there would be myriad reasons why minority businesses got such a tiny portion before we had laws and regulations. Among them could be race. In the bureaucracy, failure to pursue, lack of information about possible contracts.

The point I am trying to make is in my opinion we would have not seen the slight gain we have made had there not been laws and regulations and definite goals set.

Mr. **Mathis**. I agree 100 percent.

Mr. **Mitchell**. You quote from the GAO study which criticizes the matter of goal setting. You suggest that there not be unrealistic goals established. Is that correct?

Mr. **Mathis**. That is correct.

Mr. **Mitchell**. Let's assume the Government did $90 billion last year in Government contracting and procurement—and I think that might be a low figure.

Mr. **Mathis**. The number is closer to $110 billion.

Mr. **Mitchell**. Would 5 percent be an unrealistic goal?

Mr. **Mathis**. I think before one set a goal he would have to assess what we are buying, what the capability of these firms is and to pursue it from that perspective rather than arbitrarily picking a number.

Mr. **Mitchell**. It is my understanding that a lot of that has been done. There are a number of agencies of Government that have assessed the capability of minority firms. They keep that as a part of their record. When they set their goals they look at that assessment of minority firms.

Let me go back. The $3 billion goal that was established last year, is that unrealistic out of the $110 billion of Government business?

Mr. **Mathis**. I think what was unrealistic was the arbitrary doubling of 1977 accomplishments and then tripling that for the 1979 goal. I think that action introduced stresses.

Mr. **Mitchell**. It is my understanding that $3 billion goal that was set was accomplished only after prolonged discussion and negotiations between all the departments and then the departments agreed that with all their efforts combined that was not an unrealistic goal.

Mr. **Mathis**. It was my understanding that number was established and then it was apportioned out to the agencies.

Mr. **Mitchell**. We have two different understandings then, because certainly I am aware of persons who were in White House conferences, agency representatives or agency heads before any goal was established.

Unfortunately, the recent agencies of the Small Business Administration regarding whether or not it is still negotiating contracts with procuring agencies for the 8(a) program has generated a lot of confusion.

In the last day of testimony we heard from business representatives that SBA was holding up contracts earmarked for firms designated for standard performances or determinations.

In addition to that, apparently there is a great deal of confusion in the agencies because of the publicity given to some statements made by the present Administrator, Mr. Cardenas, that bold, new, dramatic changes would be made.

It appears, and we have received testimony, some of the agencies have said, "We aren't even going to get contractors in negotiations, they are going to stop pending further clarification from Mr. Cardenas."

Are you aware that any of this has happened?

Mr. Mathis. No, sir.

We have a data base and we did query that data base to see how well we are performing so far in fiscal 1981. It is difficult to get any meaningful data looking midstream in the year because contracts tend to be awarded toward the latter part of the fiscal year. We are unable at this point to assess how well we are proceeding against our $4.2 billion goal.

Mr. Mitchell. That is not quite responsive to my question.

Mr. Mathis. I am not aware of any agencies in a hold status pending further clarification of SBA changes to the minority——

Mr. Mitchell. What would your position be with regard to contracts that were being negotiated? Would you suggest the agencies go ahead and continue the negotiation?

Mr. Mathis. I know of no reason for them to stop. Yes, I would suggest that they proceed.

Mr. Mitchell. Then Mr. Cardenas advised us in testimony sometime ago that he would get a letter out to all of the departments of Government clarifying this situation saying that in no way should his actions be interpreted as meaning to hold up on the negotiation of contracts.

To the best of my knowledge, I have not received copies of those letters.

Have we?

Do you have any knowledge as to whether or not indeed Mr. Cardenas honored his commitment to this committee by getting such letters out to the departments?

Mr. Mathis. I have no personal knowledge but there are people in the office who monitor it closer—let me ask if they know.

Mr. Birnbaum. No.

Mr. Mitchell. Then you will have to get to Mr. Cardenas. Also, wouldn't it be helpful if you put out a letter to all departments indicating there would be no problem proceeding with the negotiation of contracts that were already in process?

Mr. Mathis. If it would be helpful, certainly we would do that. We would want to coordinate with the SBA. If they are putting out such a letter it could be redundant or meaningless for us to publish a letter.

Mr. Mitchell. They haven't, apparently, as yet. To clear up some of the confusion I want somebody to move.

Mr. Mathis. We will take an action to coordinate with SBA and if they do not intend to publish or have not published a letter, we will cause such a letter to be published soon.

Mr. Mitchell. Good. We were going to try to get the Administrator to honor a public statement that he made to this committee.

He said he would leave from the hearing and go directly to his office to get those letters out. To the best of my knowledge, this has not been done.

OFPP's statutory duty is also to provide leadership in coordination of the formulation of executive branch positions on legislation relating to procurement.

In light of this—that is a part of your mandate—what input did you have in the promulgation of the proposed SBA regulations pursuant to Public Law 96-481, that is the regulation relating to graduation criteria for the 8(a) firm?

Mr. **Birnbaum**. We spoke to the SBA about those regulations and agreed with the proposed SBA position on them. We were aware of the regulations that they were putting out in response to the statute you referred to.

Mr. **Mitchell**. They called you and said, here are the regulations?

Mr. **Birnbaum**. They actually brought them over to the OMB officials directly involved and we were invited to the meetings that were held with the OMB officials with program responsibility for the SBA program.

We were not called by SBA directly. SBA dealt with the appropriate officials in the Office of Management and Budget who in turn invited us to sit in on the meetings to discuss those regulations.

Mr. **Mitchell**. You would equate that invitation with your mandate of leadership and coordination in the formulation of executive policy?

Mr. **Birnbaum**. Yes, sir.

Mr. **Mathis**. We would have felt free to have either asked them to hold the regulations up or to change them if there was anything in the regulations that we felt was inconsistent with the law or good overall procurement policy.

Mr. **Mitchell**. I don't have any further questions at this time. Thank you.

Our next witness is Mr. Kirk Fordice with the Associated General Contractors of America.

Thank you, gentlemen, for taking the time to be before the committee this morning. We do have a copy of your complete testimony.

You have an option. You can present it in its entirety or you can speak to the major points and have it submitted for the record, whichever option you care to proceed.

TESTIMONY OF KIRK FORDICE, CHAIRMAN, HEALTH & SAFETY COMMITTEE, ASSOCIATED GENERAL CONTRACTORS OF AMERICA, ACCOMPANIED BY HUBERT BEATTY, EXECUTIVE VICE PRESIDENT, AND JOHN SROKA, ASSISTANT EXECUTIVE DIRECTOR

Mr. **Fordice**. Thank you, Mr. Chairman.

My name is Kirk Fordice, and I am a small business general contractor from the very small town of Delta, La.

With me are members of the Associated General Contractors' staff; Hubert Beatty, executive vice president and John Sroka, assistant executive director.

Mr. Chairman, in the interest of time, I will submit my prepared statement for the record and give an abbreviated version with some cost examples that I have.

Mr. **Mitchell.** Without objection, your entire statement will be submitted for the record.

Mr. **Fordice.** Thank you, sir.

I am here today representing the Associated General Contractors of America, a national association of approximately 30,000 firms, including more than 8,400 of the Nation's leading general contracting companies.

Well over 90 percent of AGC's members are small businesses as defined by SBA's size standards. I, too, am a small businessman. In fact, the construction industry is dominated by small businesses.

We requested to testify today to recommend that the Small Business Administration's 8(a) program not be used in the construction industry.

We make this recommendation for three reasons: First, the 8(a) program does not achieve its stated purpose in construction because it is not compatible with the nature of the industry; second, the extremely high cost it engenders to the Government and the taxpaying public; and, third, because it impacts harshly on other small business construction firms.

First, let me address the 8(a) program's incompatibility with the very nature of the construction industry. Construction is dominated by the competitive bidding system with award to the lowest responsible bidder.

Owners, both private and public, benefit from this competitive bid system by receiving top quality work for the lowest possible price.

Contractors benefit by the assurance that an equitable opportunity to participate and bid on any work is open to all. Competition assures that the industry will remain open.

To survive in the construction industry, then, one must learn to be competitive; one must learn to submit the lowest responsible bid. Yet, the 8(a) program, the stated purpose of which is to promote the competitive viability of socially and economically disadvantaged firms, never requires the firms to be competitive, never requires, the firms to bid.

The 8(a) program in construction is a sole source negotiation program—not even competitive negotiation—but sole source.

One has to wonder how a firm can learn to be competitive, without ever having to compete. Giving a contract to a firm in the 8(a) program and negotiating the price for the work, does not help that firm in the slightest toward becoming a competitive business.

In fact, it removes the 8(a) contractor from that portion of the process in which competitive skills are developed.

Once a competitive contract is won, a contractor must use his technical skills. These skills also are not developed by the 8(a) program because SBA allows an 8(a) construction firm to subcontract up to 85 percent of the work, and we understand that this 85-percent subcontracting level is almost always reached.

Subcontracting is, of course, a part of construction. However, 85 percent of a job is an extremely high subcontract percentage, and, in fact, would not be allowed on most Federal construction contracts which require that the contractor perform between 50 percent and 80 percent of the work with his own forces.

Retaining only 15 percent of the construction contract would generally result in the 8(a) firm serving only as a conduit to pass along payment to the subcontractor or subcontractors.

An 8(a) firm, incidentally, is not required to subcontract that 85 percent of the work to another disadvantaged business, or even another small business.

The Army Corps of Engineers uses three methods for achieving its disadvantaged business utilization goal—open competitive bidding, subcontracting requirements, and the 8(a) program.

Open competitive bidding in fiscal year 1980 and thus far in fiscal year 1981 has resulted in as many contract dollars to disadvantaged firms as either the 8(a) program or the subcontracting requirements.

In fact, in some corps programs, specifically their military program, the competitive bid system has resulted in more contract dollars going to disadvantaged firms than by way of the 8(a) program.

One must wonder, based on these statistics, if the 8(a) program in construction is necessary.

Despite the fact that the 8(a) program is not relevant to participation in the construction industry, construction has been relied on heavily by agencies and the SBA to achieve 8(a) usage.

The recent GAO report on the 8(a) program included a breakdown of the firms which are included in the 8(a) portfolio.

The business category with the largest number of participating firms was construction, at 34 percent.

Even this subcommittee's intention of spreading the 8(a) program's utilization to nontraditional areas has been twisted toward reliance on construction contracts.

I am, of course, referring to the pilot program imposed on the Department of Army. As we understand the intent of the pilot program, it is supposed to utilize nontraditional, high technology, and high volume procurements—procurements which have not been a signficant part of the 8(a) program in the past.

However, at last year's hearing before the Senate Small Business Committee, the Army testified that over one-third, 11 of 29 pilot program reservations, were construction projects, and SBA continues to select construction projects for use in the 8(a) pilot program.

In further attempts to achieve disadvantaged business utilization goals, larger and larger construction contracts have been given to the 8(a) program.

Just recently the Interior Department's Bureau of Reclamation awarded a $16.4 million construction contract to an 8(a) firm.

How can a firm large enough and sophisticated enough to handle a $16.4 million construction contract be considered a small disadvantaged business? Perhaps the 85 percent subcontracting allowance provides the answer.

We suspect that projects of this size are being awarded 8(a) merely because their volume quickly adds up and helps an agency achieve its disadvantaged business utilization goal.

Our second reason for ending the 8(a) program in the construction industry is its extremely high and unreasonable costs to the Government and the taxpaying public.

Whenever competition is limited, or eliminated as in the case of the 8(a) program, higher costs usually result. This has been difficult to pin down, however, because once a construction project has been pulled from the open competitive market for delivery to the 8(a) program, there is no opportunity for competitive bids for comparison purposes.

Recently, however, we have come across two projects which point out clearly the tremendous cost of sole source negotiating an 8(a) construction contract.

A highway relocation project in Idaho was removed from the competitive market by the Federal Highway Administration and given to the SBA for the 8(a) program.

SBA provided a contractor for the job who submitted a proposal of $3.9 million for the work.

This price was $911,000 over the Government's estimate and FHWA was reluctant to pay this price. The negotiations continued and FHWA eventually agreed to remove a portion of the work from the contract.

In addition, SBA agreed to give the 8(a) contractor $350,000 in business development expense funds for the purchase of equipment. With these changes the 8(a) firm was able to offer a price of $3.025 million.

It should be noted that this 8(a) contractor's past construction experience had been in the $200,000 or less range with limited highway construction experience and that non-8(a) construction firm was to be a major subcontractor and would in fact be in charge of the project.

FHWA decided not to award the contract to the 8(a) firm but to competitively bid the entire work, including the previously removed portion.

Three months later, 19 firms bid for the work. When the bids were opened on May 7, 1981, the low bid price was $2.355 million. The Government and the taxpayers saved nearly $1 million.

When added to the additional $350,000 in business development funds that would not be paid out, the competitive price represents a 40-percent savings and this, even after 3 inflationary months had passed.

A second project, with which I am intimately familiar, was given by the Corps of Engineers to the SBA for 8(a) utilization. A price of $416,000 was negotiated for the work with an 8(a) firm.

The project, however, was eventually put out for competitive bid. Bids were finally opened 14 months after the contract could have been offered for competition. The low bidder, my firm, was awarded the contract at a price of $188,950. This represents a 120-percent savings to the taxpayer.

As in the previous example, there were 19 bidders on this job and these were from six different States. If these recent examples are indicative of the cost of the 8(a) program in construction, and we suspect they are, the waste of money to the taxpaying public is staggering.

Nineteen bidders on relatively small projects was, at one time, highly unusual. Unfortunately, this is becoming commonplace throughout the industry today and is indicative of the state of the construction market.

These conditions naturally impact all small business construction contractors. When you add to this the increased use of the 8(a) program which takes further work out of the market, you can see that the non-8(a) small business construction contractor is facing a bleak future.

As bad as this is, the problem is compounded by the way in which certain procuring agencies are administering their participation in the 8(a) program.

I speak specifically of the Army Corps of Engineers. It is this impact on other small business construction firms that is our third reason for urging the program's termination in the construction industry.

The Army policy for implementing the 8(a) program requires the corps to reserve for the SBA, which means to take out of the open competitive market, any projects which they deem are susceptible to performance by a small disadvantaged firm.

Susceptibility is a determination which is left to the discretion of the district engineer. This translates into the corps districts reserving undue quantities of contracts for the SBA.

SBA, in turn, takes many months or even 1 year and more to place the project with an 8(a) firm. For example, the Vicksburg District, in which I live and where most of my work used to be generated, reserved its entire procurement list dated March 2, 1981, for the 8(a) program. That is 100 percent of all available contracts being reserved for the SBA.

The total estimate for this work is $28 million and was reserved in an attempt to meet a $6 million disadvantaged business utilization goal.

Army Secretary Marsh, in a letter to our association, informed us that the Corps' Lower Mississippi Valley Division has reserved thus far, this fiscal year, 81 projects valued at $87 million and the four Ohio River Districts had reserved 89 contracts valued at $78 million.

The Army has indicated that much of this work will not be awarded to 8(a) firms but will eventually be returned to the corps for competitive bid since the SBA will undoubtedly be unable to supply 8(a) contractors for all of this work.

While this may be true, there is no guarantee that 6 months or 1 year from now, when that decision is eventually made to turn these projects back to the open competitive market, there will be enough small business contractors still in business to offer competitive bids for the jobs.

Reducing the market this significantly even for a short period of time will lead to the demise of many small contractors who have provided the Government top quality work at the lowest price for years and have been ready to assist this Nation in time of natural disaster or national emergency.

This subcommittee has gone on record stating that the 8(a) program should not impact on the existing small business community.

I tell you today that your desire is not being fulfilled because my firm specifically, and many more like me, are in doubt of survival and this can be largely attributed to the 8(a) program.

We urge this subcommittee to consider our proposal that the 8(a) program no longer be used in the construction industry. Realizing that some study of our proposal may be necessary before appropriate action can be taken, we urge this subcommittee to exercise its oversight function and direct the SBA Administrator to take the following immediate steps:

One, instruct awarding agencies to limit the number of construction contracts they are offering for 8(a) utilization to an amount that will not impact on the small business contracting community;

Two, limit the size of construction contracts that can be given to the 8(a) program; and

Three, set strict time limits on how long SBA can hold a reserved contract before they must turn it back to the procuring agency for competitive bid.

[Mr. Fordice's prepared statement with attachment follows:]

PREPARED STATEMENT OF KIRK FORDICE, REPRESENTING ASSOCIATED GENERAL CONTRACTORS OF AMERICA

My name is Kirk Fordice, and I am a general contractor from Delta, Louisiana. With me are members of the Associated General Contractor's staff; Hubert Beatty, Executive Vice President and John Sroka, Assistant Executive Director.

I am here today representing the Associated General Contractors of America, a national association of approximately 30,000 firms, including more than 8,400 of the nation's leading general contracting companies. Well over 90 percent of AGC's members are small businesses as defined by SBA's size standards. I too am a small businessman. In fact, the construction industry is dominated by small businesses.

We requested to testify today to recommend that the Small Business Administration's 8(a) program *not* be used in the construction industry. We make this recommendation for three reasons: first, the 8(a) program does not achieve its stated purpose in construction because it is not compatible with the nature of the industry; second, the extremely high cost it engenders to the government and the taxpaying public; and third, because it impacts harshly on other small business construction firms.

First, let me address the 8(a) program's incompatibility with the very nature of the construction industry. This industry, typified by family owned businesses that work close to home, is extremely competitive and open. Construction is not dominated by a few firms, rather it is dominated by the competitive bidding system with award to the lowest responsible bidder. Owners, both private and public, benefit from this competitive bid system by receiving top quality work for the lowest possible price. Contractors benefit by the assurance that an equitable opportunity to participate and bid on any work is open to all. Competition assures that the industry will remain open. To survive in the construction industry, then, one must learn to be competitive; one must learn to submit the lowest responsible bid. Yet, the 8(a) program, the stated purpose of which is to "promote the competitive viability of socially and economically disadvantaged firms," never requires the firms to be competitive, never requires the firms to bid. The 8(a) program in construction is a sole source negotiation program—not even competitive negotiation—but sole source. One has to wonder how a firm can learn to be competitive, without ever having to compete. Giving a contract to a firm in the 8(a) program and negotiating the price for the work, does not help that firm in the slightest toward becoming a competitive business. In fact, it removes the 8(a) contractor from that portion of the process in which competitive skills are developed. Surveying the market of available work, deciding which jobs you have the capabilities of performing, estimating the job, obtaining bonding, soliciting competitive subcontract bids and supply quotes, and finally preparing a competitive bid are the skills which are needed to become competitive in construction. The 8(a) program undermines the development of these skills.

Once a competitive contract is won, a contractor must use his technical skills to schedule the progress of the work, coordinate delivery of materials, manage the performance of the construction by his employees, and ensure that if any subcontractors are on the job, they are performing their tasks and keeping the entire progress of the job on schedule. These skills also are not developed by the 8(a) program because SBA allows an 8(a) construction firm to subcontract up to 85 percent of the work, and we understand that this 85 percent subcontracting level is almost always reached. Subcontracting is, of course, a part of construction. Depending on the nature of the construction project, the general contractor may complete the work entirely with his own forces, or may subcontract segments of the work as he deems appropriate. However, 85 percent of a job is an extremely high subcontract percentage, and, in fact, would not be allowed on most federal construction contracts which require that the contractor perform between 50 percent and 80 percent of the work with his own forces. Retaining only 15 percent of the construction contract would generally result in the 8(a) firm serving only as a conduit to pass along payment to the subcontractor or subcontractors. An 8(a) firm, incidentally, is not required to subcontract that 85 percent of the work to another disadvantaged business, or even another small business. We are left wondering how long a firm which has been developed in this fashion will last when, or if, it is ever removed from the program or required to compete for work with the rest of the industry.

Perhaps one of the best arguments in support of our position comes from the statistics compiled by the Army Corps of Engineers to demonstrate its efforts at achieving its disadvantaged business utilization goal. The Corps uses three methods for achieving its goal—open competitive bidding, subcontracting requirements and the 8(a) program. Open competitive bidding in fiscal year 1980 and thus far in fiscal year 1981 has resulted in as many contract dollars to disadvantaged firms as either the 8(a) program or the subcontracting requirements. In fact, in some Corps programs, specifically their military program, the competitive bid system has resulted in more contract dollars going to disadvantaged firms than by way of the 8(a) program. One must wonder, based on these statistics, if the 8(a) program in construction is necessary. I have no doubt that if the 8(a) program were discontinued today, those firms owned by disadvantaged persons which have been working within the competitive bid system would continue to grow and continue to be successful while many of those that are participants in the 8(a) program would find themselves unprepared for the competitive market.

Despite the fact that the 8(a) program is not relevant to participation in the construction industry, construction has been relied on heavily by agencies and the SBA to achieve 8(a) usage. The recent GAO report on the 8(a) program included a breakdown of the firms which are included in the 8(a) portfolio. The business category with the largest number of participating firms was construction, at 34 percent. When you look at the other classifications, however, you begin to realize that the impact is even greater than this number implies. Construction is the only category that only includes one industry. The other categories, for example "professional services" or "nonprofessional services" are broad groupings which can cover a variety of industries. No other single industry is impacted as significantly as construction.

Even this subcommittee's intention of spreading the 8(a) program's utilization to non-traditional areas has been twisted toward reliance on construction contracts. I am, of course, referring to the "Pilot Program" imposed on the Department of the Army. As we understand the intent of the Pilot Program, it is supposed to utilize non-traditional, high technology, and high volume procurements—procurements which have not been a significant part of the 8(a) program in the past. However, at last year's hearing before the Senate Small Business Committee, the Army testified that over one third, 11 of 29 Pilot Program reservations, were construction projects, and SBA continues to select construction projects for use in the 8(a) "Pilot Program."

In further attempts to achieve disadvantaged business utilization goals, larger and larger construction contracts have been given to the 8(a) program. Just recently the Interior Department's Bureau of Reclamation awarded a $16.4 million construction contract to an 8(a) firm. How can a firm large enough and sophisticated enough to handle a $16.4 million construction contract be considered a small disadvantaged business? Perhaps the 85 percent subcontracting allowance provides the answer. We suspect that projects of this size are being awarded 8(a) merely because their volume quickly adds up and helps an agency achieve its disadvantaged business utilization goal.

Our second reason for ending the 8(a) program in the construction industry is its extremely high and unreasonable costs to the Government and the taxpaying public. Whenever competition is limited, or eliminated as in the case of the 8(a) program, higher costs usually result. This has been difficult to pin down, however, because once a construction project has been pulled from the open competitive market for delivery to the 8(a) program, there is no opportunity for competitive bids for comparison purposes. We are seeking out specific instances where comparisons are available, and hope to include these in our oral statement.

A dozen or more bidders on relatively small projects, was, at one time highly unusual. Unfortunately, this is becoming commonplace throughout the industry today and is indicative of the state of the construction market. These conditions naturally impact all small business construction contractors. When you add to this the increased use of the 8(a) program which takes further work out of the market, you see that the non 8(a) small business construction contractor is facing a bleak future. As bad as this is, the problem is compounded by the way in which certain procuring agencies are administering their participation in the 8(a) program. I speak specifically of the Army Corps of Engineers. It is this impact on other small business construction that is our third reason for urging the program's termination in the construction industry.

The Army policy for implementing the 8(a) program requires the corps to reserve for the SBA, which means to take out of the open competitive market, any projects which they deem are susceptible to performance by a small disadvantaged firm. Susceptibility is a determination which is left to the discretion of the district engineer. This translates into the Corps Districts reserving undue quantities of contracts for the SBA. SBA, in turn, takes many months or even a year and more to place the project with an 8(a) firm. For example, the Vicksburg District, in which I live and where most of my work used to be generated, reserved its entire procurement list dated March 2, 1981, for the 8(a) program. That is 100 percent of all available contracts being reserved for the SBA. The total estimate for this work is $28 million and was reserved in an attempt to meet a $6 million disadvantaged business utilization goal. Army Secretary Marsh, in a letter to our Association, informed us that the Corps' Lower Mississippi Valley Division has reserved thus far, this fiscal year, 81 projects valued at $87 million and the four Ohio River Districts had reserved 89 contracts valued at $78 million. The Army has indicated that much of this work will not be awarded to 8(a) firms but will eventually be returned to the corps for competitive bid since the SBA will undoubtedly be unable to supply 8(a) contractors for all of this work. While this may be true, there is no guarantee that six months or a year from now, when that decision is eventually made to turn these projects back to the open competitive market, there will be enough small business contractors still in business to offer competitive bids for the jobs.

It is impossible for a contractor to do any future planning and to decide which jobs he will bid on if he cannot be sure what work will be available. Even if all of these contracts are eventually turned back open competitive bid, reserving them en masse and for an indefinite time period plays havoc with a contractor's projection of workforce needs and equipment requirements. This particularly impacts the small contractor who is not able to provide contingencies to cover these uncertainties by making use of this workforce and equipment on other jobs. Reducing the market this significantly even for a short period of time will lead to the demise of many small contractors who have provided the government top quality work at the lowest price for years and have been ready to assist this nation in time of natural disaster or national emergency.

This subcommittee has gone on record stating that the 8(a) program should not impact on the existing small business community. I tell you today that your desire is not being fulfilled because my firm specifically, and many more like me, are in doubt of survival and this can be largely attributed to the 8(a) program.

We urge this subcommittee to consider our proposal that the 8(a) program no longer be used in the construction industry. Realizing that some study of our proposal may be necessary before appropriate action can be taken, we urge this subcommittee to exercise its oversight function and direct the SBA Administrator to take the following immediate steps:

(1) instruct awarding agencies to limit the number of construction contracts they are offering for 8(a) utilization to an amount that will not impact on the small business contracting community;

(2) limit the size of construction contracts that can be given to the 8(a) program;

(3) set strict time limits on how long SBA can hold a reserved contract before they must turn it back to the procuring agency for competitive bid.

ANSWERS TO SUBCOMMITTEE'S SUPPLEMENTAL QUESTIONS

1. In AGC's statement to the subcommittee, we recommended that the 8(a) program not be used in the construction industry. The recommendations presented at the end of the statement are merely stopgap measures—actions to be taken pending elimination of the program in the construction industry—to mitigate the severe impact the 8(a) program is presently having on the small business construction ocntracting community. AGC's fundamental position remains unchanged; the 8(a) program should not be used in the construction industry.

As an interim measure, AGC recommends that the percentage of contracts reserved (or offered) in a given procurement period to the 8(a) program be limited to no more than 50 percent of the contracting agency's goal for the same period for utilization of small business concerns owned and controlled by socially and economically disadvantaged individuals. This goal, as we are sure the subcommittee is aware, is mandated by P.L. 95-507, but is not an 8(a) goals; it may be achieved in a variety of ways including open competitive bidding. In fact, statistics compiled by the Army Corps of Engineers to demonstrate its efforts at achieving its P.L. 95-507 disadvantaged business utilization goal reveal that open competitive bidding in fiscal year 80 and thus far in fiscal year 81 has resulted in as many contract dollars to disadvantaged firms as either the 8(a) program or subcontracting requirements. Thus, assuming that the P.L. 95-507 goal is reasonable and represents a number that can realistically be achieved by disadvantaged businesses in a given area, 8(a) offerings should be limited to no more than 50 percent of the P.L. 95-507 goal.

Such a limination would not only reduce the potential for contracting agencies to rely on the 8(a) program as a primary or exclusive means of attaining the P.L. 95-507 goal, it would also obviate the methods now used by agencies to reserve contracts for the 8(a) progrm which are having a severe impact on the remainder of the small business community. The Army policy, for example, of reserving for the 8(a) program all contracts which are susceptible to performance by a small disadvantaged firm also means that all contracts that are within the range of small non-8(a) construction contractors are being reserved as well, and will remain so—unavailable for open competitive bidding—until such time as SBA uses them for the 8(a) program or turns them back to the Corps. Hence, the severe impact on the non-8(a) small business community.

Question 1 also asks specifically about the situation in the Vicksburg District. The fiscal year 81 P.L. 95-507 goal for this district is $6 million, or approximately 8 percent of the total procurement (based on fiscal year 80 purchases). Consequently, Vicksburg should have only reserved for the 8(a) program, at most, 4 percent of the contracts offered in its March 2 bulletin and not the full 100 percent ($28 million) that they did reserve.

2. No construction contracts over $500,000 should be given to the 8(a) program. Contracts up to this size are within the realistic range of a small disadvantaged business and provide a broad experience in various construction and business practices.

3. The SBA should have a maximum of 14 days to provide the contracting agency with a qualified 8(a) contractor and a maximum of 14 additional days should be allowed for price negotiation. In no event should the contract be unavailable for open competitive bid beyond 28 days.

4. The contracting agency should set percentage limits on the allowable subcontracting. These percentage limits should be the same that would be set if the contract had not been given to the 8(a) program. Generally, this would mean a limit of 15 to 50 percent on subcontracting depending on the nature of the construction.

5. The 8(a) program in construction does not apply to HUD since HUD administers no direct federal construction procurement program, only federally-assisted (grant) programs. Over use of the 8(a) program in other direct federal construction awarding agencies has not been as severe as in the Army Corps of Engineers.

6. A small business disadvantaged set-aside program, like the 8(a) program and like the small business set-aside program, is simply not needed or justified in construction procurement. Construction procurement, unlike any other type of procurement. Construction procurement, unlike any other type of procurement, is dominated by open competitive sealed bidding with award to the lowest responsible bidder. Sheltered markets, like the 8(a) program and set-aside programs, only tend to prepare a contractor for more sheltered markets.

We anticipate that if a disadvantaged business set-aside program is established, it, like the 8(a) program and the small business set-aside program, will turn into a "cradle to grave" program and that in a few years we will all be reading AGO reports on "The SBA Disadvantaged Set-Aside Program—A Promise Unfulfilled."

7. Over 90 percent of the association's member firms are defined as small businesses, according to the SBA criteria. Yet, at the direction of these same small businesses, AGC has historically and consistently opposed th use of small business set-asides in construction. AGC members believe that the competitive nature of the construction industry and federal procurement procedures have always assured ample opportunity for qualified contracting firms of all size and composition to obtain their fair share of federal outlays for public works. Set-asides are an unneeded artificial prop which do nothing but limit competition and increase the cost of construction to the detriment of the taxpaying public.

Mr. MITCHELL. Thank you for your testimony.

I had the very fortunate experience a few years ago in participating in one of your annual meetings in Las Vegas. I was only there for 1 day to be a part of the seminar. I don't know how long you were there. You have a total of 30,000 members?

Mr. **Fordice**. Yes; that includes 8,400 general contractors. The others provide support to the construction industry such as material men, bonding companies, insurance companies, they are AGC associate members.

Mr. **Mitchell**. Could you give me an idea as to how many of your membership are minority?

Mr. **Fordice**. I have no idea, Mr. Chairman.

Mr. **Mitchell**. I think when I was at your convention it was indicated that less than 1 percent.

Mr. **Fordice**. I have no idea. I don't usually dwell on those things and I don't know who is what color or how many are what color. I just plain don't know.

Mr. **Mitchell**. I understand, I won't push you. Do you attend the conventions?

Mr. **Fordice**. Yes.

Mr. **Mitchell**. Based upon your general observation at the conventions, do you see a fairly good representation of minorities?

Mr. **Fordice**. As far as membership? I see a fairly good representation of minorities. I still don't know what percent of our membership are minorities.

I don't even know what minorities are, Mr. Chairman. I just don't know how to answer this question. I don't know what it is and I think a lot of Americans don't know what it is.

Mr. **Mitchell**. I won't push you. I will just give you an illustration. The man sitting in this chair is a minority.

You say that 85 percent of the work done by 8(a) firms is subcontracted out and that is almost universal.

Mr. **Fordice**. Yes.

Mr. **Mitchell**. What is the source of your data?

Mr. **Sroka**. That comes from the Small Business Administration's operating procedures and that is unusual to the construction portion of the 8(a) program. I believe no other 8(a) procurement in any other industry has such a high subcontracting allowance.

Mr. **Mitchell**. Are you sure it was subcontracting out or was joint venturing taken into account also?

Mr. **Sroka**. No; it was subcontracting.

Mr. **Fordice**. I don't see a lot of joint venturing in the 8(a) program. In the specific example I gave where my company was low bidder, I know that the gentleman who had previously been given that job at twice the price intended to do no work. I don't think he had ever looked at the plans. He was going to take in quite a bit of money but he wasn't going to perform the construction work and, obviously, wasn't going to learn anything about construction.

Mr. **Mitchell**. Except that I have personal knowledge of 10 years working with minority firms there are many firms that they do very little subcontracting. They take the bull by the horns, carry the ball by themselves.

In the construction business do you ever run into cost overruns?

Mr. **Fordice**. In Federal procurement absolutely not. We bid competitively a firm price backed up by a bond. I may overrun but I don't get recompensed for it.

Mr. **Mitchell**. I was just thinking of the construction that had been done right here on Capitol Hill, the new Senate Office Building which is being done not by minorities but has an enormous cost overrun.

In the very building in which we sit, the Rayburn Building, there was an enormous cost overrun. This was done on the basis of competitive bidding.

Mr. **Fordice**. It is a matter of semantics. I have been in the business 34 years doing business mainly with the Federal Government and we have never overrun a penny. There is no mechanism for it. We guarantee the price.

Mr. **Mitchell**. You do such a good business then.

Mr. **Fordice**. No; I think you are talking about overruns over somebody's estimate, not overruns over a normal Federal construction contract.

Mr. **Mitchell**. But it is over the estimate; it is still costs.

Mr. **Fordice**. Granted, Mr. Chairman.

Mr. **Mitchell**. On page 8 in your testimony you say this about the 8(a) program, that it should not impact on existing small businesses.

> I tell you today that your desire is not being fulfilled because my firm specifically, and many more like me, are in doubt of survival and this can be largely attributed to the 8(a) program.

I rarely watch television because it is not very entertaining but I did happen to catch a show that dealt with the construction business in general, how the bottom has fallen out because of a number of things: high interest rates, slowdown on contracts being awarded, speculation about where the economy is going.

Yet you say it's specifically the 8(a) firm——

Mr. **Fordice**. Everything you say is quite right, Mr. Chairman. I tried to characterize the compounding effect on what you mentioned. Certainly the market is as bad as it has ever been. When you compound that with the fact that in spot areas—Vicksburg is a classic example—all of the work is removed from the market for 8(a) this makes it impossible.

I happen to be a backer of the President's program 100 percent, as is our association, and that is going to involve cuts in public works construction expenditures—dollars—that is my market.

I have no objection to that. I can live with that. I can survive but you can't do that and then take all of the reduced amount that is left over and give that to 8(a), and say you can't compete because you don't meet the criteria and hope to expect other small businesses to survive.

Mr. **Mitchell**. I just am looking at the State of Vermont where there are very few minority contractors, to the best of my knowledge. I think we have hardly any 8(a) businesses in the State of Vermont. Yet, the construction industry is depressed there.

Mr. **Fordice**. It is depressed everywhere.

Mr. **Mitchell**. That is right. You seem to make a broad generalization this is largely attributed to the 8(a) firm. It is too broad and sweeping a generalization.

Mr. **Fordice**. I come here from the trenches and I am working every day to survive and one of my businesses is corps construction——

Mr. **Mitchell**. We are not talking about your particular situation now.

Mr. **Fordice**. There are many others like me.

Mr. **Mitchell**. I am talking about your broad statement this is largely attributed to the 8(a) program. That means nationwide. That just can't hold up.

Mr. **Fordice**. Well, let me tell you it is a most serious threat to many contractors from one end of this country to the other, Mr. Chairman.

Mr. **Mitchell**. You say you are being crowded out, some of your contractors are being crowded out. Yet, we have received consistent testimony from friends and foes alike of the program that minorities are getting somewhere less than 2 percent of all Government contracts.

Those who oppose the 8(a) program have testified to this. Those who support it have testified to this. Less than 2 percent could crowd you out?

Mr. **Fordice**. I have tried to characterize to you spot situations. Yes, that most certainly can occur due to the impact of the already low market and in setting aside overly large amounts because a man is interested in making his goal.

I am sure you read "Promise Unfulfilled." The whole theme throughout is that this whole thing is goal oriented; it is doubling, and tripling. If you see the curve it is a geometric progression that makes more and more pressure exerted throughout the Federal chain of command and it ends up where I live, it means a threat.

It means I am probably not going to be able to survive and others like me.

Most certainly it can run us out of business. It is a geometric curve that is going up and up, and the pressure on the agencies is unbelievable to make that goal. Their efficiency reports are based on it.

Mr. **Mitchell**. I would take into account the danger of spot concentrations. It would be unrealistic not to take that into account. But I would vigorously oppose the idea that 2 percent of all Government contracts in construction—and that is not even in construction, that is everything—would crowd out firms who are in general across the country.

I would also have a great deal of difficulty in terms of eliminating any goals because in the last colloquy that just took place it was indicated prior to any kind of goalsetting there was just no participation for minorities in the Government.

Mr. **Fordice**. When you were talking to OFPP you were trying to get an explanation of that. One thing you asked was if it was due to racism and bureaucracy. If I may, I would like to address that. I don't see how in the world it can be. I spend a lot of time with the bidding process, and somebody please explain to me how an open competitive bid, sealed in an envelope, publicly opened, publicly read aloud, and publicly awarded to the lowest bidder can have racism entered in that procedure. It is one of the cleanest procedures I know of.

Mr. **Mitchell**. At some time in the future when we have more time I will walk you through the nuances and subtleties of racism.

Mr. **Beatty**. May I comment?

Mr. MITCHELL. Yes.

Mr. BEATTY. I would like to respond in more detail as to the number of minority contractors in the association. I have been with the association since 1962 and have attended all of our national meetings, including our 1964 convention in Las Vegas. I am not sure which meeting you attended.

We do not have a substantial number of minority contractors, but it is growing. I am sure you are familiar with the fact there are at least two national associations of minority contractors, AMC and NAMC. We attempt to work harmoniously with them.

What I can assure you is that in the past 19 years there has never been a single instance where the Associated General Contractors of America has rejected the membership application of any contracting firm. I have been at chapter meetings where we have invited in local groups of minority contractors to affiliate with the chapter and thus through the chapters to us.

They have declined to do so despite some relaxation in the cost. I am not sure why, whether they perceive us incorrectly or whether they prefer to affiliate with organizations that seem to be catering directly to minority interests as distinct from construction.

Mr. MITCHELL. I certainly commend you for your efforts. I think it is very good that you are trying to do this but we still have to deal with the bottom line, whatever that is and it is relatively small. Is that correct?

Could you give me a little harder number? I know of two minority firms that are a part of the association. Could you give me a more precise number as to the total number?

Mr. BEATTY. I have heard a figure of about 200. I believe that is inaccurate and is on the low side. Of the 30,000 firms in the association, as Mr. Fordice indicated, a little more than 8,400 are general contracting firms. The remainder of the firms also come to us through the chapters. They are suppliers, subcontractors, bonding companies.

I wouldn't dispute your assertion the figure is low. It is low. I also see it as low in terms of the number of minorities at our meetings.

We would perhaps have 60 committee meetings in the course of one of our conventions. On our equal opportunity committee I believe there are perhaps six or seven minority contractors and/or management representatives, minorities who are engaged perhaps by Caucasian contractors.

We have in one of our chapters a man who will be president next year who is a minority. To my knowledge, that person is the first minority president of one of our chapters. We have 113 of them.

But I would also point out to you and perhaps it is a mark of our times, for the first time in 19 years I have met a female who is also one of our chapter presidents. There are changes occurring.

Mr. MITCHELL. Thank you for your explanation. Your efforts are commendable. Thank you very much for taking the time to be here.

Our next witness is Juanita Watts, Director, Office of Small and Disadvantaged Business Utilization, Department of the Army. You may proceed as you desire.

TESTIMONY OF JUANITA WATTS, DIRECTOR, OFFICE OF SMALL AND DISADVANTAGED BUSINESS UTILIZATION, OFFICE OF THE SECRETARY OF THE ARMY, ACCOMPANIED BY COL. ALBERT R. SPAULDING, DEPUTY DIRECTOR, AND GENE BLAYLACK, ASSOCIATE DIRECTOR, OFFICE OF CHIEF OF ENGINEERS

Ms. WATTS. Mr. Chairman and members of the committee, I am Juanita Watts. I serve as the Director for Small and Disadvantaged Business Utilization in the Office of the Secretary of the Army.

Appearing with me is my deputy, Col. Albert R. Spaulding, and Mr. Gene Blaylack, the Associate Director for Small and Disadvantaged Business Utilization in the Office of the Chief of Engineers.

The Army has appeared before this committee on several occasions during the past several years and consistently and fully endorsed the concept of the regular 8(a) program.

Our performance record supports our words when we endorse and support the intent of Congress to assist small and disadvantaged business firms in their efforts to participate in the productive aspects of the country's economy.

During fiscal year 1980, the Army continued its efforts to identify those contracting opportunities that were susceptible for execution by small disadvantaged firms.

A total of $923 million in contract requirements were offered to or requested by the Small Business Administration for the 8(a) program. Of that amount $273.4 million or 30 percent was converted to contracts.

These awards represented 1.8 percent of the total amount of contracts awarded by the Army to all business firms for work in the United States.

During the first 6 months of the current fiscal year, the Army has offered or the SBA has requested approximately $989 million for the 8(a) program; $228.7 million or 23 percent has thus far been converted to awards. This amounts to 2.6 percent of the total contracts awarded during this period.

I would like to just briefly address the individual performance by the Army's Corps of Engineers in the 8(a) program. In fiscal year 1980 the Corps of Engineers offered approximatley $390 million to the SBA for possible contracting under the 8(a) program; $59.4 million or 15 percent was actually awarded.

These awards represented 1.9 percent of the total amount of awards made by the corps.

In the first 6 months of 1981 the corps has offered $559 million. Of that amount, $66.6 million or 12 percent has been converted to awards. The 8(a) awards represent 4.1 percent of their total amount of awards made during this period.

Mr. Chairman, I would like to add for the record with respect to the corps programs several Members of Congress as well as others in the construction industry have raised concerns about effects on the small business sector of the construction industry of the administration of some features of the 8(a) program.

The Assistant Secretary of Army for Civil Works has begun to examine some of these concerns and he expects to be developing recommendations as our review progresses.

We reiterate our recognition of the validity of a properly managed regular 8(a) program. The program is probably one of the most practicable means of providing business opportunities for disadvantaged firms.

It is an obvious fact that most of these firms cannot compete head to head with either small or large firms. Yet, there is a great deal of entrepreneurial potential among persons in disadvantaged societal groups that should and must be encouraged.

The regular 8(a) program conceptually is an excellent method of devloping such firms and the Army will do whatever is feasible, consistent with our primary mission of defense readiness, to support the regular 8(a) program objectives.

Mr. Chairman, this concludes my prepared statement. I would be pleased to respond to any questions you may have on this subject.

Mr. MITCHELL. Thank you for your concise statement. Let me go back to page 1 of your statement. You say:

> During the first 6 months of the current fiscal year, the Army has offered or the SBA has requested approximately $989 million for the 8(a) program. $228.7 million or 23 percent has thus far been converted to awards. This amounts to 2.6 percent of the total contracts awarded during this period.

In your opinion or the opinion of the Army, does 2.6 represent crowding out of small business other than minority business?

Ms. WATTS. No.

Mr. MITCHELL. Let's go down a little further. On your next page you say:

> In the first 6 months of 1981 the Corps has offered $559 million. Of that amount, $66.6 million or 12 percent has been converted to awards. The 8(a) awards represent 4.1 percent of their total amount of awards made during the period.

Do you feel that 4.1 percent is a disadvantage to nonminority firms that that crowds them out?

Ms. WATTS. No. I am talking about 4.1 percent of the corps. No.

Mr. MITCHELL. Who is the gentleman who is undertaking the study of the 8(1) program?

Ms. WATTS. That is the Assistant Secretary for Civil Works.

Mr. MITCHELL. Do you know whether or not he is looking at the possible spot concentration? I think he should.

Ms. WATTS. That has been brought to our attention.

[Additional material supplied for the hearing record by Ms. Watts follows:]

SMALL BUSINESS ADMINISTRATION'S MANAGEMENT OF 8(a) PROGRAM

QUESTIONS FROM CONGRESSMAN MITCHELL AND ANSWERS FROM JUANITA P. WATTS, DIRECTOR, OFFICE OF SMALL AND DISADVANTAGED BUSINESS UTILIZATION, DEPARTMENT OF THE ARMY

Question 1

Some minority business groups contend that 8(a) contracts are easier and quicker to award because they can be negotiated rather than opened to competitive bid. Do you agree with this? What is the perception of the Army procurement officials with whom you have had contact?

Question 2

The primary purpose of these hearings is to review the Small Business Administration's implementation and management of the 8(a) program. There has been much criticism of SBA in this regard, both from within and outside the government. Since the Army has a large 8(a) program, and presumably much contact with SBA, I would appreciate you providing us with an evaluation of the SBA's performance.

Can you describe for us what you consider to be SBA's weaknesses in handling this program?

Inconsistencies among regions;

Lack of communications between district, regional, and Washington offices;

Too much decentralization, lack of responsiveness to headquarters by field offices;

Inconsistent capabilities among SBA field staff dealing with the Army.

Question 3

In both 1979 and 1980, less than 30 percent of the Army contracts offered for 8(a) have actually been awarded to minority firms. For the Corps of Engineers, the proportion awarded is even smaller (12%-15%). Why are so few of the procurement set-asides actually awarded? Doesn't this delay and interfere with the procurement process?

Question 4

The new SBA Administrator has proposed several significant changes in the 8(a) program in recent months. Have any of these changes deterred Army procurement officials from offering contracts to 8(a) firms?

Question 5

I understand that the Corps of Engineers' Vicksburg, Mississippi district recently reserved an entire procurement list from SBA. Apparently, other districts also have reserved large parts of their requirements for SBA.

A. Why is this being done?

B. Is it reasonable to expect that all of these contracts will be awarded to firms in the 8(a) program?

C. Doesn't this practice cause unnecessary delays and uncertainty in awarding contracts? What impact does this have on the orderly procurement of items required by the Corps?

Question 6

Associated General Contractors has said that some 8(a) procurement contracts have been more costly than they would have been if offered competitively. How often is the Army required to pay a higher price for goods or services as the result of a contract being awarded through the competitive bid process?

Question 7

The General Accounting Office has recommended that 8(a) be restructured as a two-tier program. In the first tier, disadvantaged firms would enter the program with strict limitations imposed. Once a firm reaches its limit, it would move to a second tier in which it would compete for contracts with other minority firms. This would be similar to the small business set-aside program. The rationale for this proposal is that it enables 8(a) firms to make a gradual transition into the competitive market. What is your reaction to this proposal?

Question 1 answer

I do not agree that 8(a) contracts are easier and quicker to award than solicitations that are open to competitive bid. Although there will be exceptions, the Army experience is that competitive procedures are easier and quicker than negotiated 8(a) procedures. Experience on offers to SBA under the 8(a) program is that the process from beginning (offer) to end (contract) has been lengthy. Special problems include the length of time to obtain SBA acceptance of offers, certification that the 8(a) firm is competent to do the job, establishing a fair price, and negotiating with both SBA and its subcontractor. This perception of difficulty in negotiating 8(a) contracts is shared by Army procurement officials. However, the Army 8(a) program has not weighed the ease or difficulty or procurement in making determinations to offer requirements to SBA for subcontracting to disadvantaged firms.

Question 2 answer

Your request for an evaluation by the Army of SBA's performance on the 8(a) program solicits an opinion about SBA operations for which we do not collect data. It is difficult from the Army vantage point objectively to determine the causes for deficiencies attributed to SBA management of the program. The weaknesses you have used as illustrations in your question could have led or contributed to the special problems cited in the above response to question 1.

Question 3 answer

The majority of requirements offered under the 8(a) program are not converted to contracts because (i) SBA determines that they do not have firms qualified to perform the work, (ii) more projects are offered than can be accomplished by its portfolio of qualified firms, and (iii) SBA cannot administratively process the volume of offers. Offers are often withdrawn when SBA does not expeditiously respond. In general, this failure to convert offerings does delay the procurement process. The small proportion of offers eventually awarded by the Corps of Engineers (COE) resulted in part from its use of different procedures caused by special conditions not experienced by other Army commands. COE projects are offered to SBA prior to the completion of the specifications and details which are necessary for competitive solicitation. That early offering by COE, plus its wide range of projects provides SBA with added variety and time to match 8(a) firms to the construction requirements which will be ready for solicitation at a later time. A significantly larger number of offerings, but with an anticipated smaller percentage of actual conversions to 8(a) contracts, is the natural result. The COE has not experienced significant delays in the procurement process.

Question 4 answer

The SBA Administration's proposed changes in the 8(a) program have not resulted in observed deterrance to offer contracts under the 8(a) program.

Question 5 answer

COE districts have offered significant portions of their requirements to SBA, as was noted in response to question 3. But only a small portion will result in 8(a) contracts. In order to put the COE 8(a) program in perspective, the four districts in the Lower Mississippi Valley Division, which includes Vicksburg, have awarded or plan to award a total of 108 competitive contracts valued at $463 million in fiscal year 1981. For the same period, that Division has offered 81 other projects to SBA, valued at $87 million. Through April 1981, 11 8(a) contracts had been awarded with a value of $2 million. COE reports that in the Vicksburg District, less than 1 percent of their contract dollar awards through April 1981 have been made to firms under the 8(a) program. The COE procedures have not resulted in unnecessary delays and uncertainty in awarding contracts

Question 6 answer

I assume the intended question is "How often do we pay higher prices to 8(a) firms than would have been paid through the competitive process?" The Army pays "fair market price" in its contracts with SBA under the 8(a) program. There may be a differential between that price and the lowest price that would have resulted from a competitive buy for the same supplies or services. The differential, if any, would vary in each case, and cannot be readily estimated. If the 8(a) firm's offered price is excessive, an attempt is made to negotiate price down to the "fair market price" range. Failing that, the procurement is withdrawn from the 8(a) program.

Question 7 answer

The GAO proposal for the establishment of a two-tier program, which was outlined in its report to Congress "The SBA 8(a) Procurement Program—A Promise Unfulfilled", dated 8 April 1981, is partially acceptable to the Army. A second tier, with competition among 8(a) firms under the current program seems to be a good idea. We believe this could be accomplished without a statutory change to the current 8(a) program. SBA support and implementation are necesary. The Army does not support that portion of the GAO proposal which calls for a new "disadvantaged small business set-aside program."

Additional layering on top of established preferential programs would not be welcomed. It would further complicate the procurement process, and dilute the effects of other preferential programs. The Army believes that a well managed 8(a) program under the current laws can accomplish the desired result.

Mr. MITCHELL. I would have some concern if, for example, in one area everything was made 8(a). I just don't think that would be the right thing to do.

On the other hand, the very basic fact that I wanted to establish I think you have assisted me in establishing is that the percent of awards is not injurious to other than minority businesses.

Thank you very much for your testimony.

It has been three long hearings and I see some people who have been here for each hearing. I certainly want to thank the witnesses from today and all of the other witnesses who have participated. This concludes the first phase of this inquiry.

The subcommittee will be studying all of the testimony and certainly we intend to make some recommendations for change in the 8(a) program.

I will close this hearing by once again announcing my unequivocable support for the retention of an 8(a) program. I think I am echoing at least the sentiment of the members of this subcommittee because from time to time we have heard them speak to the importance of the 8(a) program. All agree there should be some changes but any attempt to demolish this program would be, in my opinion, unconscionable.

Thank you very much for your participation.

[Whereupon, at 11:12 a.m., the subcommittee adjourned, to reconvene subject to call of the Chair.]

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